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Federal Certificate Regulation of Produce Gas Sales: Initial Rates and Related Problems

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FEDERAL CERTIFICATE REGULATION OF PRODUCER GAS SALES: INITIAL RATES AND RELATED PROBLEMS

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FEDERAL CERTIFICATE REGULATION OF PRODUCER GAS SALES: INITIAL RATES AND RELATED PROBLEMS

by
N. Kenneth Scott, Jr.*

I. INTRODUCTION

NATURAL gas is one of the nation's most important sources of energy. Statistics for the year 1961 show that natural gas was consumed in more than thirty-two million residences located in every state except Maine, Vermont, and Hawaii; in 1930 natural gas was used in only five million residences.¹ During this period, the quantity of gas consumed residually increased elevenfold.² This spectacular growth in demand has resulted from the inherent superiority of natural gas over rival fuels,³ its relatively low cost, and the tremendous growth of the system of pipelines linking natural gas producing areas with the large population centers.⁴ Pipeline expansion was particularly impressive following World War II,⁵ and so was the growth in demand for natural gas. During the decade between 1940 and 1950, overall consumption of gas increased 227 per cent, and residential consumption increased 270 per cent.⁶ By 1961, overall consumption had increased 493 per cent, and residential consumption had increased 732 per cent over 1940 levels.⁷

Because of the enormous increase in demand for natural gas since 1930 (and particularly since 1940), it was to be expected that the price of gas would increase, both at the point of production and at

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¹ U. S. Dep't of Commerce, Statistical Abstract of the United States 727 (1963); U. S. Dep't of the Interior, 1961 Minerals Yearbook Vol. 2, Fuels 313 (1962).

² U. S. Dep't of Commerce, Statistical Abstract of the United States 727 (1963).

³ "The inherent advantages of natural gas are clear and indisputable. It is a clean and convenient fuel, available instantly on demand, and readily sensitive to precise thermostatic control. It needs neither handling nor storage by the consumer, and leaves neither smoke nor ash. It comes ready to burn and its flame, easily ignited and controlled, develops its maximum heating capacity at once." American Gas Association, *Natural Gas, A Study in Industry Pioneering* 5-6 (1964). Substantially the same view was expressed by Mr. Justice Jackson in his dissenting opinion in the *Hope* case. *FPC v. Hope Natural Gas Co.*, 320 U.S. 591, 635 (1944).

⁴ This system has grown from 42,000 miles in 1929 to 52,000 miles in 1932, 77,000 miles in 1945, and 190,000 miles in 1961. U. S. Dep't of Commerce, Statistical Abstract of the United States 539 (1961); FTC, *Utility Corporations*, S. Doc. No. 92, 70th Cong., 1st Sess., pt. 84-A, p. 27 (1936).

⁵ More than 65,000 miles of natural gas transmission lines were built in the decade 1945-1955. U. S. Dep't of Commerce, Statistical Abstract of the United States 539 (1963).

⁶ *Id.* at 727.

⁷ *Ibid.*

the point of consumption. Between 1930 and 1940, however, the average price per Mcf⁸ of gas at the point of production actually *declined* from 7.6 cents to an all time low of 4.5 cents.⁹ Reacting to the postwar boom in demand, the price of gas at the well rebounded to 6.5 cents in 1950 and reached 15.1 cents in 1961.¹⁰ The average price per Mcf at the burner tip of all gas consumed increased from 21.4 cents in 1930 to 21.7 cents in 1940, 26.6 cents in 1950, and 51.0 cents in 1961.¹¹ The average burner tip price per Mcf of gas consumed residually increased from 67.8 cents in 1930 to 71.1 cents in 1940, decreased to 69.0 cents in 1950, and then increased to 107.0 cents in 1961.¹² These comparisons become more meaningful if account is taken of the decrease in purchasing power of United States currency that has occurred since 1930. Expressed in terms of 1930 currency value, the average prices (expressed in cents) per Mcf of natural gas in the years in question were:¹³

	1930	1940	1950	1961
At point of production	7.6	5.4	4.5	8.3
At point of consumption (all)	21.4	25.9	18.5	28.5
At point of consumption (residential)	67.8	84.8	48.0	58.8

Thus, despite the very substantial increase in demand for natural gas since 1930, its price in terms of constant purchasing power has changed little since that time. Indeed, the price to residential consumers actually has decreased.

As indicated above, the catalyst which has triggered increased gas consumption has been the growth of the system of pipelines carrying gas from producing areas to areas of high potential consumption. Producer¹⁴ and consumer both necessarily are dependent on such pipelines, for in the absence of a connecting pipeline gas can be neither sold by the former nor bought by the latter. The large investment required necessarily limits the number of pipelines constructed.¹⁵ The dependence of producer and consumer upon pipe-

⁸ One thousand cubic feet.

⁹ U.S. Dep't of Commerce, Statistical Abstract of the United States 727 (1963).

¹⁰ *Ibid.*

¹¹ *Ibid.*

¹² *Ibid.*

¹³ Computed using data concerning purchasing power of the dollar and consumer price indexes found in U. S. Dep't of Commerce, Statistical Abstract of the United States 351, 356 (1963). For a similar comparison, see Garfield, *Price Regulation of New Supplies of Natural Gas*, 71 Pub. Util. Fort. 15-16 (1963).

¹⁴ As used in this Article, the term "producer" means "independent producer," i.e., an entity that produces gas, but neither owns nor has corporate affiliation with a gas pipeline.

¹⁵ The costs of large diameter pipelines have been reported to range "considerably upward from \$100,000 per mile." Hargrove, *Characteristics and Problems of Interstate Natural Gas Transmission*, 1 Economics of the Gas Industry 255, 257 (1962). At the end of 1959, investment in investor-owned natural gas pipelines was approximately \$8.1 billion. American Gas Association, Historical Statistics of the Gas Industry 399 (1961). At the end of 1962,

lines, together with the lack of competition among the pipelines (due to their relatively small number), vested in them at an early date potential power to exploit both producers and consumers.¹⁶ It became apparent in the late 1930's that control of the few pipelines which were in existence had passed to an even fewer number of large holding companies.¹⁷ Because the important cross-country pipelines were engaged in interstate commerce, the states were held powerless to regulate sales by such pipelines to local distributors for resale to ultimate consumers.¹⁸

With this situation before it, Congress enacted the Natural Gas Act of 1938.¹⁹ This act confers upon the Federal Power Commission authority to regulate (1) "the transportation of natural gas in interstate commerce"; (2) "the sale in interstate commerce of natural gas for resale for ultimate public consumption for domestic, commercial, industrial, or any other use"; and (3) "natural gas companies engaged in such transportation or sale."²⁰ Specifically exempted from such regulation is "the production or gathering of natural gas."²¹ Until 1954 the Commission applied this exemption to sales

there were just 40 interstate pipelines which had (1) over 250 miles of transmission lines and (2) sales for resale in excess of 50% of total sales. FPC, *Statistics of Natural Gas Companies at VII* (1962).

¹⁶ "The keystone . . . is in control of the pipe lines. Only through pipe lines can natural-gas producers and consumers deal with each other. With pipe lines in the hands of strong interests working in quite close harmony, those independent producers who desire to transport rather than process their output may be deprived of the consumer market. Both may be at the mercy of those who control the vital link of transportation." FTC, *Utility Corporations*, S. Doc. No. 92, 70th Cong., 1st Sess., pt. 84-A, pp. 609-610 (1936). The impact upon producers of the shortage of pipeline capacity in the 1930's has been described by a former general counsel of the Commission as follows:

Having been caught between large over-supplies of natural gas and totally inadequate pipeline outlets to ripe markets, many of the producers prior to passage of the Natural Gas Act in 1938 agreed to sell at ridiculously low prices gas which would be otherwise flared. These low prices came at the beginning of an inflationary cycle and not only created trouble for the producers who had to agree to inadequate prices but also made attractive for argument unfair comparisons when new supplies were sold later at several times the distress rates. Gatchell, *Some Basic Factors and Trends in Public Utility Regulation*, 12 Ann. Inst. on Oil and Gas Law and Taxation 23, 40 (1961).

¹⁷ FTC, *Utility Corporations*, S. Doc. No. 92, 70th Cong., 1st Sess., pt. 84-A (1936). See *FPC v. Hope Natural Gas Co.*, 320 U.S. 591, 610 (1944).

¹⁸ *State Corp. Comm'n v. Wichita Gas Co.*, 290 U.S. 561 (1934); *Public Util. Comm'n v. Attleboro Steam & Elec. Co.*, 273 U.S. 83 (1927); *Missouri v. Kansas Natural Gas Co.*, 265 U.S. 298 (1924). See *Pennsylvania v. West Virginia*, 262 U.S. 553 (1923); *Oklahoma v. Kansas Natural Gas Co.*, 221 U.S. 229 (1911). States in which interstate gas was consumed were permitted to regulate the sale of such gas to ultimate consumers. *Pennsylvania Gas Co. v. Public Serv. Comm'n*, 252 U.S. 23 (1920); *Public Util. Comm'n v. Landon*, 249 U.S. 236 (1919).

¹⁹ 52 Stat. 821 (1938), as amended, 15 U.S.C. §§ 717-717w (1958) (hereinafter referred to as the "act"). For a detailed analysis of the legislative history of the act, see Note, *Legislative History of the Natural Gas Act*, 44 Geo. L.J. 695 (1956).

²⁰ 52 Stat. 821 (1938), as amended, 15 U.S.C. § 717(b) (1958).

²¹ *Ibid.*

by producers of natural gas.²² However, on June 7, 1954, the United States Supreme Court ruled in the *Phillips* case²³ that producer sales in interstate commerce of natural gas for resale were subject to regulation under the act, notwithstanding the "production and gathering" exemption. The Commission was immediately faced with the task of regulating several thousand gas producers. The nature and size of the gas producing industry presented the Commission with unprecedented regulatory problems of great complexity—problems which, after ten years of effort, remain substantially unsolved.²⁴

A significant number of the Commission's post-*Phillips* problems have involved producer applications for certificates of public convenience and necessity. Under section 7(c) of the act,²⁵ a natural-gas company²⁶ may not engage in the sale of natural gas in interstate commerce for resale "unless there is in force with respect to such natural-gas company a certificate of public convenience and necessity issued by the Commission authorizing such acts. . . ." Certificate applications must be made to the Commission in writing and must be verified under oath.²⁷ The Commission must set such applications for hearing upon reasonable notice to interested persons.²⁸ If upon such hearing the Commission finds that "the applicant is able and willing properly to do the acts and to perform the service proposed and to conform to the provisions of the act and the requirements, rules and regulations of the Commission thereunder, and that the proposed . . . sale . . . , to the extent authorized by the certificate, is or will be required by the present or future public convenience and necessity," a certificate "shall be issued to any qualified appli-

²² For a discussion of the history of the exemption to 1954, see Atkinson, *Federal Regulation of Natural Gas—The Independent Producers' Status*, 13 Sw. L.J. 425, 431-38 (1959).

²³ *Phillips Petroleum Co. v. Wisconsin*, 347 U.S. 672 (1954).

²⁴ By no means the least of the regulatory problems which the *Phillips* decision, *supra* note 23, thrust upon the Commission was the very practical one of how to cope with the staggering increase in its work load. In the year before *Phillips*, the Commission had 283 certificate filings and 706 rate filings; during the first nine months after *Phillips*, the Commission had 5,673 producer certificate filings and 10,042 producer rate filings. Mason, *Problems in Regulation Under the Natural Gas Act of Interstate Operations of Producers*, ABA Proceedings, Section of Mineral & Natural Resource Law 30, 31 (1961). Six years after *Phillips*, the Commission stated that even if its staff were immediately tripled, it would be 82½ years behind in its producer rate work load. *Phillips Petroleum Co.*, 24 F.P.C. 537, 546, 13 O. & G.R. 343, 352, (1960), *rehearing denied*, 24 F.P.C. 1008 (1960), *aff'd sub nom.* *Wisconsin v. FPC*, 303 F.2d 380 (D.C. Cir. 1961), *aff'd*, 373 U.S. 294 (1963).

²⁵ 52 Stat. 824 (1938), as amended, 15 U.S.C. § 717f(c) (1958).

²⁶ Section 2(6) of the act defines a "natural gas company" as "a person engaged in the transportation of natural gas in interstate commerce, or the sale in interstate commerce of such gas for resale." 52 Stat. 821 (1938), 15 U.S.C. § 717a(b) (1958).

²⁷ Act § 7(d), 56 Stat. 83 (1942), 15 U.S.C. § 717f(d) (1958). The form and contents of such applications are prescribed in detail by Commission regulations. 18 C.F.R. §§ 157.23-157.27 (1961).

²⁸ Act § 7(c), 52 Stat. 824 (1938), as amended, 15 U.S.C. § 717f(c) (1958).

cant therefor."²⁹ If the Commission does not make these findings, "such application shall be denied."³⁰ The Commission is authorized, however, "to attach to the issuance of the certificate and to the exercise of the rights granted thereunder such reasonable terms and conditions as the public convenience and necessity may require."³¹ Pending the determination of an application for a certificate, the Commission may issue in cases of emergency a temporary certificate without notice or hearing "to assure maintenance of adequate service or to serve particular customers."³²

Foremost among the problems which have arisen with respect to certification of producer sales has been the determination of an appropriate initial rate. Prior to 1959 the Commission took the position, with only one exception,³³ that it should not determine rate questions in producer certificate proceedings. In 1959, however, the Supreme Court held that a producer seeking certification of a gas sale has the burden of proving that the price he proposes to charge initially is required by public convenience and necessity.³⁴ This broad standard has proved difficult to apply. The Commission has changed its position several times concerning the meaning of the standard as applied to producer rates and how it may be met. Other subsidiary but nevertheless important problems have confronted the Commission in certifying producer sales.

It is the purpose of this Article to analyze the problems which have arisen with respect to producer certificate cases, to discuss the law applicable to such problems, and to suggest appropriate changes in or additions to existing law.³⁵ Problems involving permanent cer-

²⁹ Act § 7(e), 56 Stat. 83 (1942), 15 U.S.C. § 717f(e) (1958).

³⁰ *Ibid.*

³¹ *Ibid.*

³² Act § 7(c), 52 Stat. 824 (1938), as amended, 15 U.S.C. § 717f(c) (1958). Provision for temporary "authorizations" of producer sales has been made by Commission regulation. 18 C.F.R. § 157.28 (1961). Gas may be sold without a certificate for a maximum period of sixty days "where imminent danger to life and property can be eliminated by such sale." 18 C.F.R. § 157.29 (1961).

³³ *Cities Serv. Gas Co., Signal Oil & Gas Co.*, 14 F.P.C. 134, 5 O. & G.R. 428 (1955), *rehearing denied*, 15 F.P.C. 1020, 5 O. & G.R. 625 (1956), *aff'd*, 238 F.2d 771 (3d Cir. 1956), *cert. denied*, 353 U.S. 923 (1957).

³⁴ *Atlantic Ref. Co. v. Public Serv. Comm'n*, 360 U.S. 378 (1959). This case is commonly referred to, and will be referred to in the text, as *CATCO*, which is derived from the names of the producers involved: Cities Service Production Co., Atlantic Refining Co., Tidewater Oil Co., and Continental Oil Co.

³⁵ For another recent discussion of this subject, see Johnson, *Producer Rate Regulation in Natural Gas Certification Proceedings: CATCO in Context*, 62 Colum. L. Rev. 773 (1962). For information concerning other aspects of Commission regulation of producers, see Atkinson, *Federal Regulation of Natural Gas—The Independent Producers' Status*, 13 Sw. L.J. 425 (1959); DeCrane, *Federal Power Commission: Regulatory Evolution at the Ten-Year Mark*, 15 Ann. Inst. on Oil and Gas Law and Taxation 271 (1964); Mosburg, *Regulation of the Independent Producer by the Federal Power Commission*, 16 Okla. L. Rev. 249 (1963);

tificates³⁶ and problems involving temporary certificates will be treated separately. Because of its pre-eminent importance, the bulk of this Article will be concerned with the initial rate issue. As has been indicated above, the Commission has vacillated in this important area and the law has evolved, for the most part, on an *ad hoc* basis. For this reason, the first part of this Article will trace in considerable detail the evolution of the law with respect to initial rates.

II. PERMANENT CERTIFICATES

A. Initial Rates

Normally, title to natural gas is transferred from producer to pipeline as produced, pursuant to a long-term gas sales contract that sets forth, *inter alia*, the price which will be paid for the gas.³⁷ The Commission has provided by regulation³⁸ that such contracts shall be filed by gas producers as their rate schedules.³⁹ Soon after the *Phillips* case⁴⁰—as initial prices under gas sales contracts between producers and pipelines increased in response to the ever growing demand for gas—the Commission's staff and various interveners began to contest producer certificate applications on the issue of initial rates. The contention was made that gas producers, upon filing an application for a certificate, have the burden of showing that public convenience and necessity requires the proposed sale at the price provided in the sales contract. In the absence of such a showing, it was argued, the application must be denied or the certificate must be issued with a

Smith, *The Operator Who Has Discovered A Gas Pool—What Next?*, Rocky Mt. Min. Law Inst. 79 (1962); Stone, *Federal Power Commission Developments of Significance to Independent Producers of Natural Gas*, 13 Ann. Inst. on Oil and Gas Law and Taxation 1 (1962).

³⁶ The words "permanent certificate" are not found in the act, but are used by the Commission and will be used in this Article to describe a certificate with no specific limit on its term that is issued by the Commission after a hearing and upon the basis of the findings required by § 7(e) of the act, 56 Stat. 83 (1942), 15 U.S.C. § 717f(e) (1958).

³⁷ For further information concerning such contracts, see Leeston, Crichton & Jacobs, *The Dynamic Natural Gas Industry* 309 (1963); Gregg, *Negotiating and Drafting Gas Purchase Contracts on Behalf of the Seller*, 13 Ann. Inst. on Oil and Gas Law and Taxation 87 (1962). On rare occasions, all gas in a given field is sold to a pipeline while still in place in the reservoir, or gas is sold directly from producer to consumer, the pipeline performing a transportation service without taking title to the gas. On this subject, see Doggett, *Marketing by Producer of Natural Gas Through Means—Conventional and Unconventional*, 1 Economics of the Gas Industry 193, 210 (1962).

³⁸ 18 C.F.R. §§ 154.92-154.93 (1961).

³⁹ Section 4(c) of the act, 52 Stat. 822 (1938), 15 U.S.C. § 717c(c) (1958), provides that every natural gas company shall file with the Commission "schedules showing all rates and charges for any . . . sale subject to the jurisdiction of the Commission, and the classifications, practices, and regulations affecting such rates and charges, together with all contracts which in any manner affect or relate to such rates, charges, classifications, and services."

⁴⁰ *Phillips Petroleum Co. v. Wisconsin*, 347 U.S. 672 (1954).

rate condition attached pursuant to the Commission's authority under section 7(e) of the act.⁴¹

I. Evolution of Existing Law

a. Post-Phillips—Pre-CATCO

(1) *Signal* One of the earliest contested producer certificate cases was the *Signal* case,⁴² in which the Commission issued a producer certificate upon the condition that the initial contract price be reduced from 12 cents to 10 cents per Mcf. The Commission based its action upon uncontroverted evidence introduced by interveners in the case that the highest price then being paid for gas in the area of the sale was 10 cents per Mcf, that the average price in the area was 9.9 cents per Mcf, and that the proposed sale at 12 cents would force area prices to that level. Under these circumstances, the Commission deemed the imposition of a price condition to be appropriate for the purpose of "'holding the line' and preserving the *status quo*."⁴³

Institution of an investigation into the lawfulness of the rates in question under section 5(a) of the act⁴⁴ was regarded by the Commission as inadequate to cope with the situation, because of the complexity of such proceedings and because of the "long delay" involved in reaching a final decision, during which "there is no way of undoing the damage done to the public."⁴⁵ The Commission made it clear that in imposing a rate condition it did not purport to determine a just and reasonable rate within the meaning of section 4 of the act.⁴⁶ The Commission held that in a proceeding upon a certificate application the "applicant-seller has the burden of proving all elements of its application so that we may conclude that the service proposed is or will be required by the present or future public convenience and necessity."⁴⁷ The level of rates proposed, the Commission concluded, was "a vital element of such proof," which was not sustained by a

⁴¹ 56 Stat. 83 (1942), 15 U.S.C. § 717f(e) (1958).

⁴² *Cities Serv. Gas Co., Signal Oil & Gas Co.*, 14 F.P.C. 134, 5 O. & G.R. 428 (1955), *rehearing denied*, 15 F.P.C. 1020, 5 O. & G.R. 625 (1956), *aff'd*, 238 F.2d 771 (3d Cir. 1956), *cert. denied*, 353 U.S. 923 (1957).

⁴³ 14 F.P.C. at 149, 5 O. & G.R. at 441.

⁴⁴ 52 Stat. 823 (1938), 15 U.S.C. § 717d(a) (1958). This section of the act provides in substance that the Commission shall determine the just and reasonable rate applicable to any sale of natural gas upon finding, after a hearing held upon its own motion or upon complaint, that the existing rate is "unjust, unreasonable, unduly discriminatory, or preferential."

⁴⁵ 14 F.P.C. at 147, 5 O. & G.R. at 439.

⁴⁶ 52 Stat. 822 (1938), as amended, 15 U.S.C. § 717c (1958). This section of the act requires that "all rates and charges made, demanded, or received by any natural-gas company for or in connection with the . . . sale of natural gas subject to the jurisdiction of the Commission shall be just and reasonable. . . ." Section 4(a) of the act also declares that "any such rate or charge that is not just and reasonable is . . . unlawful."

⁴⁷ 14 F.P.C. at 145-46, 5 O. & G.R. at 438.

showing that the price is the product of an "arm's length" transaction.⁴⁸

The Court of Appeals for the Third Circuit affirmed the Commission's order.⁴⁹ The court specifically upheld the Commission's authority to attach price conditions to producer certificates and found substantial evidence supporting the Commission's exercise of that power in this case.

The *Signal* case is significant because it is the *only* instance prior to the *CATCO* decision⁵⁰ in which the Commission imposed a rate condition upon a producer certificate and because it represents an approach strikingly similar in some respects to that taken by the Supreme Court four years later in *CATCO*. After the *Signal* case, the Commission continued to enunciate the principles there announced, but a shift in approach was apparent.

(2) *Tamborello* More representative of the Commission's approach in the *Phillips-CATCO* interim was the *Tamborello* decision,⁵¹ issued the same day as the *Signal* decision. In *Tamborello*, the Commission, although declaring that it possessed the power to do so, refused to attach rate conditions to producer certificates. After discussing its prior policies regarding the attachment of rate conditions to pipeline certificates, the Commission said:

However, because the economic and other conditions presented in certificate applications filed by independent producers are substantially different from those presented in certificate applications filed by interstate pipe line companies, the Commission has not deemed it prudent to expend the time required to resolve rate issues at this stage, nor has it found it practical to inquire into the reasonableness of producer rates in all producer certificate proceedings.⁵²

The Commission stated that the interests of distribution companies and consumers would be protected by the Commission's authority "to inquire later into the reasonableness of the rates proposed to be charged by the producers."⁵³ Noting that the proposed initial rate would result in a "negligible" (one per cent) increase in the purchaser's cost of service, the Commission concluded that "in the circumstances and considering the time which would be required to resolve any rate issues in this proceeding at this stage, we do not

⁴⁸ *Id.* at 145-47, 5 O. & G.R. at 438-39.

⁴⁹ *Signal Oil & Gas Co. v. FPC*, 238 F.2d 771 (3d Cir. 1956), *cert. denied*, 353 U.S. 923 (1957).

⁵⁰ *Atlantic Ref. Co. v. Public Serv. Comm'n*, 360 U.S. 378 (1959), discussed in text accompanying note 34 *supra* and notes 99-139 *infra*.

⁵¹ *Anthony J. Tamborello*, 14 F.P.C. 123, 5 O. & G.R. 458 (1955).

⁵² *Id.* at 126, 5 O. & G.R. at 461.

⁵³ *Ibid.*

believe that further review of the level of the rates proposed by the producers in this proceeding is warranted."⁵⁴ The Commission's approach in the *Tamborello* case set the pattern for its disposition of producer certificate applications during the remainder of the post-*Phillips*—pre-CATCO period.

(3) *Natural Gas Pipeline* In the *Natural Gas Pipeline* case,⁵⁵ the Commission refused to attach rate conditions to producer certificates authorizing sales in north Texas despite strenuous arguments that such conditions were necessary to avoid a serious disruption of prevailing prices in south-central Oklahoma. The Commission noted that in the *Signal* case:⁵⁶

[W]e made it clear that the particular circumstances presented in each case are of decisive importance in determining whether a condition like that imposed in the *Signal* case should be attached to the issuance of a certificate to a producer. These circumstances include the extent to which a convincing showing has been made that as a result of the price imposed, the prices for other sales in the area in question will be increased, keeping in mind such relevant factors as the kind and quantity of gas sold, the degree of competition present in the area, and the extent to which the producer contract in question resembles the other gas sales contracts in the area.⁵⁷

Based on the evidence before it, the Commission concluded that a disruption of south-central Oklahoma prices due to the sale in question was at most a remote possibility. It is noteworthy that because of the lack of competing buyers in that area the Commission was unwilling to regard the price paid by the only large purchaser of gas in two north Texas counties as the "prevailing price" in those counties.

In its order denying applications for rehearing,⁵⁸ the Commission stated that "the element of price to the ultimate consumer is but *one factor* to be considered in determining upon the convenience and necessity involved in a given case."⁵⁹ In this case, the Commission decided, "other elements overbalance such increases as may ensue from the certification of the producers' sales . . . at the prices authorized."⁶⁰ Further, in response to the contention that these pro-

⁵⁴ *Ibid.*

⁵⁵ *Natural Gas Pipeline Co. of America*, 16 F.P.C. 80 (1956), *amended*, 17 F.P.C. 67 (1957), *aff'd sub nom. Oklahoma Natural Gas Co. v. FPC*, 257 F.2d 634 (D.C. Cir. 1958), *petition for cert. dismissed*, 358 U.S. 948 (1959).

⁵⁶ *Cities Serv. Gas Co., Signal Oil & Gas Co.*, 14 F.P.C. 134, 5 O. & G.R. 428 (1955), *rehearing denied*, 15 F.P.C. 1020, 5 O. & G.R. 625 (1956), *aff'd*, 238 F.2d 771 (3d Cir. 1956), *cert. denied*, 353 U.S. 923 (1957).

⁵⁷ 16 F.P.C. at 91-92.

⁵⁸ 17 F.P.C. 85 (1957).

⁵⁹ *Id.* at 88. (Emphasis added.)

⁶⁰ *Ibid.*

ducer prices had not been shown to be just and reasonable, the Commission concluded, quoting its *Signal* decision,⁶¹ that " 'a proceeding of this nature cannot and is not intended to take the place of a proceeding under Section 4 or 5 of the Act.' "⁶²

The Commission's refusal to impose rate conditions upon the producer certificates in this case was affirmed by the Court of Appeals for the District of Columbia.⁶³ The court held that the Commission was vested with discretion as to whether or not to attach rate conditions to producer certificates and that the exercise of this discretion, unless abused, should not be disturbed by the courts. In finding that the Commission did not abuse its discretion, the court noted that (1) the volume of gas reserves involved was great, and (2) other gas in the area, for which 12 cents per Mcf was being paid, was casing-head gas, which was not as valuable as the gas well gas involved in this case, for which a 13.9 cents per Mcf price was provided by contract. The court concluded that a comparison of the 13.9 cent price "with the prices being paid for gas well gas by other gas purchasers in relevant areas shows that [the 13.9 cent] price is *in line*."⁶⁴ This was the first judicial reference to a price "line" in a producer certificate proceeding, a concept which, as we shall see, assumed great significance after the *CATCO* case.⁶⁵ It will be remembered that the "line" concept previously was utilized by the Commission in the *Signal* case.

The court rejected the argument that if a proposed price is above the price then being paid by others in the specific area, the Commission must either impose a price condition or determine the justness and reasonableness of the price as ordinarily would be done in a proceeding under section 4 or 5 of the act. Concerning the latter alternative, the court said: "Section 4(a) states the substantive objective of the Act, that rates be reasonable; it does not specify the procedure by which this objective is to be attained. That procedure is prescribed by [sections] 4(d), 4(e) and 5(a). The Commission cannot be required to convert every certificate proceeding into a rate proceeding."⁶⁶

A vigorous dissent was written by Judge Bazelon, who argued

⁶¹ *Cities Serv. Gas Co., Signal Oil & Gas Co.*, 14 F.P.C. 134, 5 O. & G.R. 428, *rebearing denied*, 15 F.P.C. 1020, 5 O. & G.R. 625 (1956), *aff'd*, 238 F.2d 771 (3d Cir. 1956), *cert. denied*, 353 U.S. 923 (1957).

⁶² 17 F.P.C. at 88. As to §§ 4 and 5 of the act, see notes 44 and 46 *supra*, respectively.

⁶³ *Oklahoma Natural Gas Co. v. FPC*, 257 F.2d 634 (D.C. Cir. 1958), *petition for cert. dismissed*, 358 U.S. 948 (1959).

⁶⁴ *Id.* at 638. (Emphasis added.)

⁶⁵ *Atlantic Ref. Co. v. Public Serv. Comm'n*, 360 U.S. 378 (1959), discussed in text accompanying note 34 *supra* and notes 99-139 *infra*.

⁶⁶ 257 F.2d at 640.

that a proposed producer sale could not be certificated under the act if the initial price is in "substantial disparity with field price," unless the Commission imposed a rate condition or determined that the initial price was just and reasonable.⁶⁷ Judge Bazelon observed that section 4 procedures were not applicable to initial rates, that section 5(a) proceedings were notoriously long and complicated, and that no provision was made for even temporary suspension of rates or for refund of amounts received which ultimately might be found unlawful. For this reason, he concluded, the public interest in just and reasonable rates was "essentially unprotected" unless the Commission had the power and duty to protect that interest in a certificate proceeding.⁶⁸

(4) *Hope* In the *Hope* case,⁶⁹ the Commission again applied its policy that rate issues could, but in the interest of expedience should not, be dealt with in producer certificate cases. In that case it was argued by the Commission's staff that a producer applicant must show in a formal hearing that public convenience and necessity requires the sale *at the proposed price* rather than at some unspecified lower price. In the absence of such proof, it was contended, the producer fails to support his burden of proof and must be denied a certificate. The Commission rejected this position, saying:

We are of the view that if the applicant proves there is a market for the gas at the proposed price and that the project is economically feasible at the proposed price (both market and economic feasibility being factors which we consider in determining public convenience and necessity) that it has sustained its burden of going forward with the evidence, and in the absence of evidence showing that the proposed price or rate adversely affect [sic] the public convenience and necessity, *the applicant has made out a prima facie case*, and a certificate should issue to it.⁷⁰ (Emphasis added.)

This was the Commission's first statement of the elements of a *prima facie* case supporting a producer certificate application.

The Commission declared that the position advanced by the Commission's staff, if adopted, "would seriously impede the administration of the Act."⁷¹ Noting that it consistently had held abridged hearings in independent producer certificate cases since regulation of independent producers first was undertaken in 1954, the Commission stated that a change in procedure requiring a formal hearing on each pro-

⁶⁷ *Id.* at 642, 651-53.

⁶⁸ *Id.* at 649.

⁶⁹ *Hope Natural Gas Co.*, 19 F.P.C. 405 (1958).

⁷⁰ *Id.* at 407.

⁷¹ *Id.* at 408.

ducer application would bring the granting of certificates to producers to a virtual halt. The same result would occur in pipeline cases, it was said, due to the dependence of pipeline applications upon the certification of producer sales.

(5) *Seaboard* In the *Seaboard* case,⁷³ the Commission not only refused to attach a rate condition to a producer certificate, but also condemned the use of such conditions in rather broad terms:

Time and experience have attested to the soundness of our position in the *Tamborello* case and have forcibly demonstrated at least in the great majority of independent producer cases coming before us, where the price for the proposed sale has been arrived at on an arm's-length basis, that the imposition of a rate condition under Section 7(e) reducing the price proposed by the applicant for its sale of gas is neither a proper nor practicable means for protecting the consumer against prices which may not have been shown to be just and reasonable; and that the primary instrument for the protection of the consumer against excessive rates is and must continue to be the means afforded by the rate provisions of the Act.⁷⁴

The Commission noted the difficulty which would be involved in determining a substitute price if the initial price as negotiated were deemed to be excessive, and insisted that there must be "some rational basis for the new price"; it refused to apply a "'grab bag' approach" under which a price several cents lower than that proposed would be selected arbitrarily as the proper price level.⁷⁵ Field price evidence presented by the Commission's staff was regarded as having "little probative value" due to the "possible noncomparability" of the terms and conditions of the sales being considered. Some of the "factors which enter into the finally negotiated price" which the Commission thought might not be comparable from sale to sale included: (1) the period covered by the contract, (2) the volume of gas dedicated under it, (3) the kind of gas sold, (4) its heating value, (5) certain cost factors (such as the depth of sands from which production is obtained), (6) accessibility of the gas to the purchaser's pipelines, (7) the fact that the gas may be produced in conjunction with oil and must be sold to prevent its being flared, and (8) the number of pipelines competing for the gas.⁷⁶ The introduction of field price data in certificate proceedings was said by the Commission to make "difficult the timely administration of the Act."⁷⁷ Further, it concluded, rate reductions based upon such data

⁷³ *Seaboard Oil Co.*, 19 F.P.C. 416, 8 O. & G.R. 999 (1958).

⁷⁴ *Id.* at 421, 8 O. & G.R. at 1005.

⁷⁵ *Id.* at 423, 8 O. & G.R. at 1008.

⁷⁶ *Id.* at 423, 8 O. & G.R. at 1007.

⁷⁷ *Id.* at 423, 8 O. & G.R. at 1008.

without proof of the surrounding circumstances would be of doubtful validity.

Despite these statements, the Commission warned that high initial prices appearing in certain contracts were "a matter of grave concern" to it and that the possibility remained of attaching rate conditions to producer certificates if required by the facts.⁷⁷ Commissioner Connole dissented at great length, arguing that the Commission should utilize its conditioning power to reduce initial prices to the "prevailing price for a typical new sale" in the area.⁷⁸

(6) *Transco* The Commission's approach to the rate issue in producer certificate cases during this period was developed further in the *Transco* case.⁷⁹ Although the Commission conceded price to be an "element" of the public convenience and necessity "complex," it held that "in circumstances such as those which exist in this case, the importance of price in relation to the other elements involved may be materially lessened."⁸⁰ It concluded that the initial price had not been shown in this case to be "unreasonable" or productive of an "adverse effect justifying rate conditions."⁸¹ Further, the rationale of two then-recent judicial decisions⁸² was thought by the Commission to cast doubt on its "power to alter or vary the terms of contracts between producers and purchasers," contrary to the earlier decision of the Third Circuit in the *Signal* case.⁸³ The Commission suggested that the practical difficulties which it had encountered in finding "a rational and workable basis for imposing rate conditions" might be the result of "an absence of legal authority in the premises."⁸⁴ In conclusion, the Commission stated that if it were to "act as a kind of peace-time OPA for the natural-gas producing industry," undertaking to prevent all price increases and to "force back the level for all initial producer sales on the basis of a price-ceiling type of regulation," such an approach, even if valid, would "be

⁷⁷ *Id.* at 424, 8 O. & G.R. at 1009.

⁷⁸ *Id.* at 427, 433, 8 O. & G.R. at 1013, 1020. Commissioner Connole's views concerning regulation of producer prices are set forth in his article, *Threshold Prices: A Practical Proposal for Producer Pricing*, 63 Pub. Util. Fort. 23 (1959).

⁷⁹ *Transcontinental Gas Pipe Line Corp.*, 20 F.P.C. 264 (1958), *aff'd sub nom. United Gas Improvement Co. v. FPC*, 269 F.2d 865 (3d Cir. 1959), *vacated per curiam and remanded with instructions to remand to Commission*, 361 U.S. 195 (1959).

⁸⁰ 20 F.P.C. at 270-71.

⁸¹ *Id.* at 271.

⁸² The decisions in question were *United Gas Pipe Line Co. v. Mobile Gas Serv. Corp.*, 350 U.S. 332 (1956), and *Phillips Petroleum Co. v. FPC*, 258 F.2d 906 (10th Cir. 1958). In these cases it was held that the Commission has no initial rate-making power, that initial rates are established by contract by natural gas companies, and that initial rates so established may be changed only through § 4 or § 5 procedures.

⁸³ 20 F.P.C. at 272; *Signal Oil & Gas Co. v. FPC*, 238 F.2d 771 (3d Cir. 1956), discussed in text accompanying notes 42-50 *supra*.

⁸⁴ 20 F.P.C. at 272-73.

antithetical to the interests of the public and the consumer" in the long run.⁸⁵

(7) *Trunkline* In the *Trunkline* case,⁸⁶ the last major certificate decision during the period between *Phillips*⁸⁷ and *CATCO*,⁸⁸ although the certificates were issued without rate conditions, a distinct change in the Commission's approach was evident. The sales contracts in question provided for initial prices of 22 cents per Mcf in south Louisiana and 20 cents per Mcf in Texas Railroad District No. 3. The Commission summarily approved the south Louisiana sales on the basis of its prior certification of similar sales in Louisiana and in the absence of evidence that the price would affect the public interest adversely. However, the Texas sales presented a problem. With one exception, the highest prices previously certificated by the Commission in Texas were 17.5 and 18 cents per Mcf. The exception was a sale of gas produced from offshore Texas but delivered in Louisiana, at which point title passed to the purchaser.

The Commission stated that price was "an important element of public convenience and necessity," and expressed the opinion that it should give more weight to that element "so as to discourage further price increases until the need therefor can be clearly shown."⁸⁹ The Commission again indicated its concern over the implications of the two decisions which had troubled it in *Transco*⁹⁰ with respect to its power to impose rate conditions upon producer certificates, but concluded upon the basis of the *Signal* decision⁹¹ that it possessed that power.

The Commission then addressed itself to the "question of proof" in a producer certificate case. It concluded that, as a general rule, "it is not feasible or even possible in the confines of producer certificate proceedings to obtain evidence of costs."⁹² Instead, the Commission said, it had relied on "comparative field price evidence in considering the initial prices of independent producers," despite the "limitations

⁸⁵ *Id.* at 273.

⁸⁶ *Trunkline Gas Co.*, 21 F.P.C. 704, 10 O. & G.R. 343 (1959), *aff'd on another ground sub nom.* *Battle Creek Gas Co. v. FPC*, 281 F.2d 42 (D.C. Cir. 1960).

⁸⁷ *Phillips Petroleum Co. v. Wisconsin*, 347 U.S. 627 (1954). See text accompanying note 23 *supra*.

⁸⁸ *Atlantic Ref. Co. v. Public Serv. Comm'n*, 360 U.S. 378 (1959), discussed in text accompanying note 34 *supra* and notes 99-139 *infra*.

⁸⁹ 21 F.P.C. at 716-17, 10 O. & G.R. at 357-58.

⁹⁰ *Transcontinental Gas Pipe Line Corp.*, 20 F.P.C. 264 (1958), *aff'd sub nom.* *United Gas Improvement Co. v. FPC*, 269 F.2d 865 (3d Cir. 1959), *vacated per curiam and remanded with instructions to remand to Commission*, 361 U.S. 195 (1959), discussed in text accompanying notes 79-85 *supra*.

⁹¹ *Cities Serv. Gas Co., Signal Oil & Gas Co.*, 14 F.P.C. 134, 5 O. & G.R. 428 (1955), *rehearing denied*, 15 F.P.C. 1020, 5 O. & G.R. 625 (1956), *aff'd*, 238 F.2d 771 (3d Cir. 1956), *cert. denied*, 353 U.S. 923 (1957).

⁹² 21 F.P.C. at 717, 10 O. & G.R. at 358.

inherent in such evidence" due to the "many factors" affecting the comparability of various sales.⁹³ In addition to the factors affecting comparability previously set out in the *Seaboard* case,⁹⁴ the Commission mentioned the following: (1) the historical development of a particular field or producing area, (2) the distance from available markets, (3) the volume of gas being delivered, (4) the delivery pressure, (5) the provisions for future price changes, and (6) the impact of local conservation laws.⁹⁵ Despite these inherent limitations, the Commission stated that comparative field price evidence was the only feasible standard available to it in initial price cases.

The evidence in the case showed that the Texas sales might establish a new high for jurisdictional sales in the Texas Gulf Coast area and that the proposed initial price would cause the "triggering" of first party "favored nations" clauses⁹⁶ in the purchaser's existing contracts. Because of this evidence, the Commission concluded that substantial proof was necessary for it to find that the proposed 20-cent price was required by the public convenience and necessity. The Commission found such proof in evidence (1) that direct sales,⁹⁷ intrastate sales, and other nonjurisdictional sales were being made at prices near or above the price in question; (2) that due to intrastate competition, significant reserves were not available in the area at lower prices; (3) that uncertificated interstate sales in another Texas Railroad District were being concluded at prices nearly as high as those under study; and (4) that the contracts contained certain unique features (large volumes of reserves were covered, and the initial 20-cent price was to remain firm for ten years). The Commission warned that it would "closely scrutinize" any proposed sale in this area providing for price increases above 20 cents per Mcf within a period of five years and that, unless a "clear showing" was made that such prices were required by public convenience and necessity, certificates would be denied or rate conditions would be imposed.⁹⁸

⁹³ *Ibid.*

⁹⁴ *Seaboard Oil Co.*, 19 F.P.C. 416, 8 O. & G.R. 999 (1958), discussed in text accompanying notes 72-78 *supra*.

⁹⁵ 21 F.P.C. at 717, 10 O. & G.R. at 358.

⁹⁶ See Ross, *The Area Rate Proceedings: An Unsettled Experiment in Public Control of Natural Gas Prices*, 18 Sw. L.J. 163, 171 n. 24, 179 (1964).

⁹⁷ A "direct sale" is a sale from producer to consumer with no intervening change of title. Although such a sale is not a "sale in interstate commerce for resale" and, hence, is not subject to direct regulation under the Natural Gas Act, it has been held subject to indirect regulation through the Commission's authority over the pipeline's transportation service. See *FPC v. Transcontinental Gas Pipe Line Corp.*, 365 U.S. 1 (1961).

⁹⁸ 21 F.P.C. at 719, 10 O. & G.R. at 360.

b. CATCO

Proceedings in the CATCO case⁹⁹ began in September, 1956, when Continental Oil Company, Atlantic Refining Company, Cities Service Production Company, and Tidewater Oil Company (referred to as a group as CATCO) filed applications for certificates to sell gas to Tennessee Gas Transmission Company from leases covering about 95,000 acres located in the Gulf of Mexico, some 12 to 25 miles off the coast of Louisiana. The initial price provided for this gas by contract was 21.4 cents plus reimbursement of state production taxes¹⁰⁰ where applicable. Provision was made for fixed price escalations of 2 cents per Mcf five years after initial delivery and thereafter each four years during the term of the contract. The reserves covered by these contracts were extremely large, then estimated to be nearly 1.7 trillion cubic feet. In order to take this gas, the purchaser proposed to build 107 miles of pipeline at an estimated cost in excess of 16.3 million dollars.

After a two-day hearing, the presiding examiner, following existing precedent, refused to impose a rate condition as urged by eastern interveners, and issued certificates to the CATCO producers conditioned only upon the issuance of a certificate to the purchaser authorizing construction of the facilities necessary to take the gas.¹⁰¹ During the hearing, the interveners had presented evidence (1) that the CATCO companies were selling gas to the same purchaser from other offshore Louisiana areas at a price of 17 cents per Mcf, (2) that the purchaser was paying only slightly more than 10 cents per Mcf (including the state tax) for gas in southwestern Louisiana, (3) that the purchaser was not paying a price as high as 21.4 cents to any other producer under any contract, and (4) that the fixed price escalations provided in these contracts were the "steepest" in any of the purchaser's existing contracts.

The examiner, however, did not give the rate question extensive attention. He noted that "initial or other prices" paid by other interstate pipelines in onshore area under long-term contracts equalled or exceeded 20 cents per Mcf for smaller reserves and smaller potentials than those covered by the CATCO contracts.¹⁰² Steep price

⁹⁹ Continental Oil Co., 17 F.P.C. 563 (1957), *modified*, 17 F.P.C. 732 (1957), *second order modified*, 17 F.P.C. 880 (1957), *rev'd and remanded sub nom.* Public Serv. Comm'n v. FPC, 257 F.2d 717 (3d Cir. 1958), *aff'd sub nom.* Atlantic Ref. Co. v. Public Serv. Comm'n, 360 U.S. 378 (1959). See text accompanying notes 271-278 *infra* for a discussion of the proceedings on remand.

¹⁰⁰ At the time the contracts were executed, the Louisiana tax on gas production was 1 cent per Mcf.

¹⁰¹ Continental Oil Co., 17 F.P.C. 563 (1957).

¹⁰² *Id.* at 571.

escalations, he added, "are not unknown in interstate pipeline contracts."¹⁰³ In any event, the examiner concluded, the record did not contain sufficient evidence to provide a basis for price comparisons; and if such studies were undertaken, the validity of all rates entering into the comparison would be open to question—an inquiry beyond the scope of a certificate proceeding.

Exceptions to this decision were filed by the interveners and by the CATCO companies. The interveners objected to the examiner's failure to impose price conditions, and the CATCO companies objected to the single condition which the examiner had imposed: viz., that the purchaser's facilities be certificated. The Commission ruled that the evidence of record was insufficient to support "a finding that the public convenience and necessity requires the sale of these volumes of gas *at the particular rate level here proposed*."¹⁰⁴ The rate issue was said by the Commission to be particularly important in this case because (1) the size of the reserve was large, (2) the sale was from newly developed offshore fields from which large proportions of future gas supplies would be taken, and (3) the proposed price was the highest at which the sale of gas to the purchaser had been proposed. Citing its action in the *Signal* case,¹⁰⁵ the Commission concluded that on the basis of these factors the sale would not be certificated permanently "unless the rate level has been shown to be in the public interest."¹⁰⁶ Accordingly, the Commission remanded the proceedings to the presiding examiner "to determine at what rates the public convenience and necessity requires these sales to be made" under permanent certificates.¹⁰⁷ However, faced with "compelling reasons" requiring that the availability of these reserves not be postponed, the Commission issued temporary certificates to the CATCO companies authorizing the sales and to the purchaser authorizing construction of the requisite 107 miles of line. The Commission added that its action did not necessarily imply that the initial prices in question "are not in the public interest."¹⁰⁸

The CATCO companies requested a rehearing of the matter, alleging (1) that their acceptance of temporary certificates was foreclosed by the economic risks they would have to face, (2) that they could not present sufficient evidence at the hearing contemp-

¹⁰³ *Ibid.*

¹⁰⁴ *Id.* at 575. (Emphasis added.)

¹⁰⁵ *Cities Serv. Gas Co., Signal Oil & Gas Co.*, 14 F.P.C. 134, 5 O. & G.R. 428 (1955), *rehearing denied*, 15 F.P.C. 1020, 5 O. & G.R. 625 (1956), *aff'd*, 238 F.2d 771 (3d Cir. 1956), *cert. denied*, 353 U.S. 923 (1957).

¹⁰⁶ 17 F.P.C. at 575.

¹⁰⁷ *Id.* at 576.

¹⁰⁸ *Ibid.*

lated by the Commission's earlier order "within any reasonable period in the future," and (3) that they could not afford to commence construction until the initial rate question was resolved. In response, the Commission modified its previous order by issuing *permanent* certificates conditioned upon the amendment of the sales contract in a manner which would (1) reduce the initial price to 17 cents per Mcf plus tax reimbursement and (2) allow the CATCO companies to file a rate increase up to 21.4 cents plus tax reimbursement one day after deliveries were commenced.¹⁰⁹ This increase, when filed, would be suspended for only one day instead of the five months permitted by section 4(e) of the act¹¹⁰ and would be collected thereafter by the CATCO companies subject to an obligation to refund any portions later determined to be unjust and unreasonable.

The Commission repeated its position that the evidence was not sufficient to justify the proposed initial price. The price specified in the condition was said to be equal to the highest price then being paid by the purchaser for any gas produced in "the Southwest area."¹¹¹ The procedure which the Commission had devised was said by it to provide a means of protecting the interests of the consuming public while allowing the pipeline and producers to proceed with their construction programs. The Commission made it clear that it was not determining that the price provided by the condition was proper under the standards of the act.

The modified order also proved unsatisfactory to the CATCO companies. An application for rehearing was filed by the purchaser in which it stated that it was "advised that the CATCO companies were unwilling to accept the permanent certificates of public convenience and necessity granted by the . . . order because they objected to the pricing and other conditions specified in the order, and that they would terminate the contracts" on this basis.¹¹² In oral argument on the application for rehearing, the CATCO companies apparently made it clear that they objected to the price conditions contained in the order in question and would seek to dispose of their gas outside the interstate market.

Faced with the possible loss of this gas to the intrastate market, the Commission reversed its course and issued permanent certificates without a rate condition.¹¹³ By the same order, an investigation under

¹⁰⁹ Continental Oil Co., 17 F.P.C. 732, 7 O. & G.R. 515 (1957).

¹¹⁰ 52 Stat. 822 (1938), as amended, 15 U.S.C. § 717c(e) (Supp. IV, 1962).

¹¹¹ 17 F.P.C. at 734, 7 O. & G.R. at 517.

¹¹² Continental Oil Co., 17 F.P.C. 880, 881, 7 O. & G.R. 925, 926-27 (1957).

¹¹³ Continental Oil Co., 17 F.P.C. 880, 7 O. & G.R. 925 (1957). The CATCO companies accepted these certificates and began gas deliveries in the summer of 1958.

section 5 (a) of the act¹¹⁴ was instituted concerning the lawfulness of all the rates of one of the CATCO companies. Similar proceedings already were pending regarding the rates of other CATCO companies. In changing its position, the Commission said it was influenced by the great need of the public served by the purchaser for increased supplies of natural gas. The Commission concluded that "important as is the issue of price, . . . as far as the public is concerned, *the precise charge that is made initially is less important than the assurance of this great supply of gas.*"¹¹⁵ Further rehearing was denied,¹¹⁶ and the stage was set for judicial review.

Petitions to review the Commission's action were filed in the Court of Appeals for the Third Circuit by the eastern interveners. That court vacated the Commission's order and remanded the case to the Commission for further proceedings.¹¹⁷ The rationale of the court's decision was as follows:

Congress has not given the Commission power to inquire into the issue of public convenience and necessity where, as here, the applicant circumscribes the scope of that inquiry by attaching a condition to its application requiring the Commission to forego the consideration of an element which may be necessary in the formulation of its judgment. Otherwise stated, the Commission has not been endowed by Congress with jurisdiction to conduct a *limited* inquiry.¹¹⁸ (Emphasis in original.)

Upon petition of the CATCO companies, certiorari was granted by the Supreme Court.¹¹⁹ On June 22, 1959, the Supreme Court issued its opinion affirming the judgment of the Third Circuit on different grounds and remanding the applications to the Commission for further proceedings.¹²⁰ The Court ruled that the lower court was in error in deciding that the Commission had been deprived of jurisdiction by the acts of the CATCO companies. The Court noted that the proposed sales had not begun, that the sales contracts were conditioned upon the issuance of certificates, and that failure of either party to secure certificates rendered the contracts subject to termination. The Court further observed that the mere filing of an application for a certificate did not constitute the "dedication" of gas to the interstate market and that the CATCO producers were at liberty to refuse con-

¹¹⁴ 52 Stat. 824 (1938), 15 U.S.C. § 717d(a) (1958). See note 44 *supra* and accompanying text.

¹¹⁵ 17 F.P.C. 881, 7 O. & G.R. at 927. (Emphasis added.)

¹¹⁶ Continental Oil Co., 18 F.P.C. 169 (1957).

¹¹⁷ Public Serv. Comm'n v. FPC, 257 F.2d 717 (3d Cir. 1958).

¹¹⁸ *Id.* at 723.

¹¹⁹ 358 U.S. 926 (1959).

¹²⁰ Atlantic Ref. Co. v. Public Serv. Comm'n, 360 U.S. 378 (1959).

ditional certificates proposed by the Commission's second order. The Court summarized its position on this matter as follows:

While the refusal might have been couched in more diplomatic language, it had no effect on the Commission's power to act on the rehearing requested. Even though the Commission did march up the hill only to march down again upon reaching the summit we cannot say this about-face deprived it of jurisdiction. We find nothing illegal in the petitioners' rejection of the alternative price proposed by the Commission and their standing firm on their own.¹²¹

The Supreme Court affirmed the lower court on the narrow ground that there was insufficient evidence to support a finding of public convenience and necessity, a prerequisite to the issuance of the permanent certificates. However, the importance of the decision as a landmark in producer regulation resulted from its extensive dicta concerning the rate issue in producer certificate proceedings. This portion of the decision is founded on the Court's assertion that the purpose of the Natural Gas Act¹²² was to "underwrite" just and reasonable rates to the consumers of natural gas and to afford consumers "a complete, permanent and effective bond of protection" from excessive rates.¹²³ Having laid this predicate, the Court observed that gas purchasers had no protection from excessive charges collected during the pendency of section 5 proceedings, which appeared "nigh interminable," and that the Commission was not given the power to suspend initial rates under section 7. The Court concluded that a sale should not be certificated permanently unless the rate level had been shown to be in the public interest and that, if the proposed price was inconsistent with the public interest, the Commission in its discretion could attach such conditions as it believed necessary.

Arrayed on this basic frame of reasoning was an assortment of dicta to which great significance has been attributed. Conceding that the act did not require a determination of just and reasonable rates in a section 7 proceeding as it did under either section 4 or section 5, the Court said it was *not* holding that "a 'just and reasonable' rate hearing" was required prior to the issuance of a producer certificate. The Court stated it *was* holding that, in view of the "inordinate delay" involved in section 5 proceedings, the Commission must give "a most careful scrutiny and responsible reaction to the initial price proposals of producers."¹²⁴ Recognizing that rates were not the only factor bearing on the public convenience and neces-

¹²¹ *Id.* at 388.

¹²² 52 Stat. 821 (1938), as amended, 15 U.S.C. §§ 717-717w (1958).

¹²³ 360 U.S. at 388-90.

¹²⁴ *Id.* at 391.

sity and that the Commission must evaluate all factors bearing on the public interest, the Court took the position that price becomes "a consideration of prime importance" if "prices have leaped from one plateau to the higher levels of another, as is indicated here."¹²⁵ On this subject the Court said:

Where the application on its face or on presentation of evidence signals the existence of a situation that probably would not be in the public interest, a permanent certificate should not be issued.

There is, of course, available in such a situation, a method by which the applicant and the Commission can arrive at a rate that is in keeping with the public convenience and necessity. The Congress, in [section] 7(e), has authorized the Commission to condition certificates in such manner as the public convenience and necessity may require. *Where the proposed price is not in keeping with the public interest because it is out of line or because its approval might result in a triggering of general price rises or an increase in the applicant's existing rates by reason of "favored nation" clauses or otherwise, the Commission in the exercise of its discretion might attach such conditions as it believes necessary.*¹²⁶ (Emphasis added.)

The Court brushed aside the contention that the attachment of rate conditions to producer certificates would encroach on the power—recognized by the Court in previous cases¹²⁷—of natural gas companies to establish initial rates. The attachment of rate conditions was said not to be the determination of rates by the Commission or the overturning of rates agreed upon by the parties; rather, the Court concluded, such procedures "act to hold the line awaiting adjudication of a just and reasonable rate."¹²⁸

In holding that the evidence was insufficient to support the Commission's certification of the sales, the Court said that the witnesses in support of the applications "developed little more information than was included in the printed contracts" and that "no effort was made to give the 'reason why' " the initial price was higher than any previously paid by the purchaser and was some seventy per cent higher than the weighted average cost of gas to the purchaser.¹²⁹ The Court expressed surprise that evidence, if available, was not introduced concerning relative costs of production. More damaging, in the Court's view, was evidence that the proposed price greatly exceeded all other prices paid by the purchaser for gas from south Louisiana.

¹²⁵ *Ibid.*

¹²⁶ *Ibid.*

¹²⁷ *United Gas Pipe Line Co. v. Memphis Light, Gas & Water Div.*, 358 U.S. 103 (1958); *United Gas Pipe Line Co. v. Mobile Gas Serv. Corp.*, 350 U.S. 332 (1956). It will be recalled that this point was a matter of concern to the Commission in the *Transco* and *Trunkline* cases, discussed in text accompanying notes 79-98 *supra*.

¹²⁸ 360 U.S. at 392.

¹²⁹ *Id.* at 392-93.

The Court also noted that the construction of a pipeline to the producers' wells was "unsupported by evidence of practice or custom," and that the movement of producer-owned distillates by the pipeline at no cost (which was a part of the sales arrangement) was without supporting data.¹³⁰ The evidence as to whether the proposed initial price would cause "favored nation" price increases was regarded by the Court as unconvincing. The "claim" that no increase in the purchaser's rates would result from this price similarly was dismissed. No evidence was found by the Court that supported the Commission's "conclusory finding" of a public need for this gas or that the producers would seek to dispose of this gas elsewhere than in interstate commerce. The Court asserted that the sale of the great quantities of gas involved in this case "would hardly be profitable except interstate," because "some 90%" of all commercial gas moved into the interstate market.¹³¹

Justices Harlan and Frankfurter concurred¹³² in the decision on the ground that the record did not support the findings upon which the Commission based its conclusion that the public convenience and necessity required the issuance to petitioners of unconditional permanent certificates. Specifically, they noted the lack of evidence supporting two "crucial findings": (1) the public need for increased gas supplies, especially to the extent that this finding implied an immediate need which could not be satisfied from the purchaser's existing reserves, and (2) the danger of loss of the CATCO gas to the interstate market unless unconditioned certificates were issued. In view of this lack of evidence, the concurring Justices were of the opinion that consideration of the other questions sought to be presented by the parties was unnecessary.

The CATCO decision authoritatively settled the question of whether initial rates were properly an issue in certificate proceedings. In resolving this issue, however, the Court introduced some formidable new problems incident to the application of its decision. Thus, in describing instances in which permanent certificates should be denied unless conditioned as to price, the Court referred to the existence of "a situation that probably would not be in the public inter-

¹³⁰ *Id.* at 393.

¹³¹ *Id.* at 394. This assertion by the Court, for which no authority was cited, is at odds with published figures. During the year 1958, the last full calendar year before the CATCO decision, interstate shipments of natural gas totaled about 6.342 trillion cubic feet. 40 FPC Ann. Rep. 62 (1960). During the same year, total marketed production of natural gas amounted to 11.030 trillion cubic feet. U. S. Dep't of Commerce, Statistical Abstract of the United States 732 (1960). Thus in 1958, interstate shipments of natural gas were only slightly in excess of 57% of total natural gas marketed. In 1961, the latest year for which figures were available at the time of this writing, this figure was about 60%.

¹³² 360 U.S. at 394.

est.”¹³³ Later in its opinion, the Court described with somewhat greater specificity facts which would “signal” such a situation; viz, “[w]here the proposed price is . . . out of line or . . . its approval might result in . . . general price rises or an increase in . . . existing rates by reason of ‘favored nation’ clauses or otherwise.”¹³⁴ In such situations, the Court stated that price conditions might be imposed by the Commission to “hold the line” pending determination of the justness and reasonableness of the price. In reintroducing the price “line” concept into producer certificate cases, however, the Court failed to define the term. As will be seen, the problem of giving specific content to this term in individual cases has proved to be a most fertile field of controversy.

The Court not only failed to be very specific about the situations in which the imposition of rate conditions would be appropriate, but also it was equally vague concerning the kind of condition it had in mind. The condition which the Commission previously had imposed and thereafter had withdrawn in the *CATCO* proceedings was one which reduced the initial price for only one day and which then allowed the producers to file an increase to the original contract price; this increase was subject to one day’s suspension, and collection thereafter was subject to an obligation to refund those amounts later determined to exceed the just and reasonable rate. The Court seemed to have in mind this type of condition in concluding that rate conditions do not encroach upon the initial rate-making powers of natural gas companies, and that by using such conditions the Commission does not determine initial rates or overturn those agreed upon by the parties, but merely acts to protect the consuming public pending determination of the justness and reasonableness of the prices set by the parties. This is indicated even more strongly by the Court’s statement that a gas producer subject to the Commission’s jurisdiction is free “unless otherwise bound by contract,” to file rate increases with the Commission.¹³⁵ In this connection, it should be noted that the Court did not mention the Commission’s action in attaching rate conditions in the *Signal* case¹³⁶ and did not cite the court decision affirming the Commission’s action.¹³⁷ In *Signal*, it will be remembered,

¹³³ *Id.* at 391.

¹³⁴ *Ibid.*

¹³⁵ *Id.* at 389.

¹³⁶ *Cities Serv. Gas Co., Signal Oil & Gas Co.*, 14 F.P.C. 134, 5 O. & G.R. 428 (1955), rehearing denied, 15 F.P.C. 1020, 5 O. & G.R. 625 (1956), *aff’d*, 238 F.2d 771 (3d Cir. 1956), *cert. denied*, 353 U.S. 923 (1957), discussed in text accompanying notes 42-50 *supra*.

¹³⁷ *Signal Oil & Gas Co. v. FPC*, 238 F.2d 771 (3d Cir. 1956), discussed in text accompanying notes 49-50 *supra*.

the Commission attached a firm condition reducing the initial price agreed upon by the parties with no specific provision for a subsequent increase.

CATCO also indicates rather clearly that a certificate may be issued without a rate condition even if a proposed price "is out of line or . . . its approval might result in a triggering of general price rises or an increase in the applicant's existing rates" if such price is supported by a "reason why."¹³⁸ However, the Court provided no guidance concerning the kind of evidence which would show a "reason why," other than an indication that evidence of "relative costs of production" from area to area might have some weight for this purpose.¹³⁹

c. *Post-CATCO—Pre-Policy Statement*

(1) *Commission Action* During the year which followed the Supreme Court's CATCO decision, the Commission interpreted and applied that decision in many producer certificate proceedings. In determining whether a proposed price was "out of line" within the meaning of CATCO, the Commission as a general rule compared it with the highest price at which previously certificated sales were being made in the area. In making this comparison, differences between the terms and conditions of the proposed sale and of the previously certificated sales were considered and evaluated. If, after taking into account these differences, the price at which the proposed sale was to be made exceeded the highest price at which previously certificated sales were being made in the area, the proposed price was found by the Commission to be "out of line."

Upon making such a finding, the Commission usually issued certificates conditioned upon the reduction of the initial price to the level found to be the "line" in the area. The Commission, however, did not impose price conditions in all cases in which the proposed initial price exceeded the highest certificated price in the area. In some cases, the Commission found a "reason why" the contract price should not be reduced even though it was above the "line." In other cases, the Commission attached conditions reducing the initial price to a level above the "line" but below the contract price. In general, the Commission relied on evidence showing that the gas in question was especially valuable to the buyer or costly to the seller, or both, in allowing initial prices above the highest price previously certificated in the area.

During this period, however, the Commission failed to formulate

¹³⁸ 360 U.S. at 391-93.

¹³⁹ *Id.* at 393.

criteria for delineating relevant areas of comparison in determining whether proposed prices were "out of line." In some instances the Commission restricted its comparison of sales to a relatively small area; in other cases sales over a vast area were considered. In general, it seemed that the Commission was willing to extend the areal limits of its comparison as far, but only as far, as was necessary to include sales which it regarded as being comparable with the sale proposed.

One of the Commission's first certificate decisions during this period was the *South Georgia* case¹⁴⁰ in which the Commission certificated without rate conditions sales from southwestern Mississippi, east-central Louisiana, and southern Louisiana. The Commission found that these prices were not "out of line on a comparable basis" with prices at which other certificated sales to the same purchaser had been made in "the same general areas."¹⁴¹ It was observed that the purchaser had made other contracts prior to the original certification of the sale involved in *CATCO*¹⁴² at the same price at which the south Louisiana sales involved in this proceeding were to be made. Therefore, unlike *CATCO*, the proposed price would not have set a new high in the area and would not have been the highest price paid by the purchaser.

Evidence had been presented concerning the Mississippi and east-central Louisiana sales showing that the proposed prices were above the highest price previously paid in those areas. With respect to the east-central Louisiana sales, however, this showing required that price comparisons be restricted to that part of Louisiana north of the thirty-first parallel. Without commenting on this limitation of the areas of comparison, the Commission concluded that any differentials between the prices in question and the prices previously paid in the area were supported by "circumstances of the kind considered pertinent by the Court in the *CATCO* case."¹⁴³ The Commission then listed the following factors *which made these sales especially valuable to the purchaser*:¹⁴⁴ (1) the gas was to be produced from recycled gas fields permitting unusual flexibility in takes, similar to the flexibility achieved in a gas storage field; (2) minimum and maximum take provisions in the contract were unusually favorable to the purchaser; (3) the gas was to be delivered to the purchaser at a central point in the field (whereas the highest priced gas previously sold in

¹⁴⁰ *South Georgia Natural Gas Co.*, 22 F.P.C. 211 (1959).

¹⁴¹ *Id.* at 219.

¹⁴² *Atlantic Ref. Co. v. Public Serv. Comm'n*, 360 U.S. 378 (1959), discussed in text accompanying notes 34 and 99-139 *supra*.

¹⁴³ 22 F.P.C. at 219.

¹⁴⁴ *Id.* at 220-21.

Mississippi was delivered at the wellhead); (4) the gas reserves covered by these contracts were very large;¹⁴⁵ (5) these reserves were more accessible to the purchaser's markets than other reserves previously sold in an intrastate market at a higher price; (6) a large part of this gas was being bought at current prices for delivery six or seven years later; and (7) unusually high delivery pressure was required of the producers.

These benefits to the purchaser were held to outweigh the small overall increase in the cost of its purchased gas that would result from buying the gas in question at the contract prices. The Commission found that these prices would not trigger general price rises or an increase in the purchaser's rates and that a need for the gas existed on the part of the purchaser and its customers. In this connection, the absence of consumer opposition to the proposed prices was noted.

The Commission rejected an argument that the prices in question stood disapproved by virtue of the *CATCO* decision.¹⁴⁶ No basis was found for assuming that the prices involved in this case were dependent on those involved in *CATCO*. Further, the Commission stated that the Supreme Court did not hold in *CATCO* that the rate there in question or any other rate could never be substantiated, but merely that the price there proposed had not been.

The Commission's *South Georgia* decision was fairly representative of its approach to the initial rate issue in producer certificate cases during the post-*CATCO*—pre-Policy Statement period, although in some later cases the application of this approach resulted in the imposition of rate conditions. In several cases¹⁴⁷ during this period, the Commission unconditionally certificated sales from south Louisiana at the same price as those certificated in the *South Georgia* case. The Commission rejected arguments that rate conditions should be imposed because the tax reimbursement in those cases was higher than under other previously certificated area sales. In so doing, the Commission relied on *the value to the purchaser* of factors such as the

¹⁴⁵ These reserves were said to aggregate in excess of 830 billion cubic feet. *Id.* at 221.

¹⁴⁶ *Atlantic Ref. Co. v. Public Serv. Comm'n*, 360 U.S. 378 (1959), discussed in text accompanying notes 34 and 99-139 *supra*.

¹⁴⁷ *California Co.*, 22 F.P.C. 252 (1959), *vacated and remanded sub nom.* *United Gas Improvement Co. v. FPC*, 283 F.2d 817 (9th Cir. 1960), *cert. denied*, 365 U.S. 881 (1961); *Sun Oil Co.*, 22 F.P.C. 351 (1959), *set aside and remanded sub nom.* *United Gas Improvement Co. v. FPC*, 290 F.2d 133 (5th Cir. 1961), *cert. denied*, 368 U.S. 823 (1961); *Sunray Mid-Continent Oil Co.*, 22 F.P.C. 361 (1959), *vacated and remanded sub nom.* *United Gas Improvement Co. v. FPC*, 287 F.2d 159 (10th Cir. 1961); *Superior Oil Co.*, 22 F.P.C. 369 (1959), *vacated and remanded sub nom.* *United Gas Improvement Co. v. FPC*, 290 F.2d 147 (5th Cir. 1961), *cert. denied*, 366 U.S. 965 (1961); *Texas Gas Transmission Corp.*, 22 F.P.C. 378 (1959), *reversed and remanded sub nom.* *Public Serv. Comm'n v. FPC*, 287 F.2d 146 (D.C. Cir. 1960), *cert. denied*, 365 U.S. 880, 882 (1961); *Transcontinental Gas Pipeline Corp.*, 22 F.P.C. 836 (1959), *rehearing granted*, January 15, 1960 (unreported).

great size of the gas reserves or their proximity to the purchaser's pipeline. Other factors given weight by the Commission were the great need of the purchaser for the gas, the small impact of the price upon the purchaser's overall cost of gas, the absence of any triggering of general price rises as a result of the contract prices, and the necessity of offering the contract price to obtain the gas in competition with other purchasers.

In one of these cases,¹⁴⁸ however, the Commission gave consideration to *producer costs*. In that case, the Commission issued certificates to producers authorizing sales from south Louisiana at the proposed initial price of 21.5 cents per Mcf, plus tax reimbursement in the amount of 2.05 cents per Mcf. The prices were found to be "the same or lower than numerous other certificated sales in this area."¹⁴⁹ The Commission rejected the position that the effect of the CATCO decision¹⁵⁰ was to require that every producer application for a certificate to sell gas at an initial price above the "pre-CATCO" price level be denied or conditioned upon the reduction of the initial price to that level. Further, the Commission denied the contention that the "pre-CATCO" price level was 18 cents per Mcf. Although agreeing that the majority of the sales in the area of the CATCO sale had been made at prices of 18 cents or below, the Commission observed that many "pre-CATCO" sales at prices equal to the highest involved in this case had been authorized by the Commission. Sales had been made in south Louisiana as early as 1953 at 20 cents per Mcf, and sales at that price had been certificated by the Commission in 1954 and 1955. Assuming a twenty per cent increase in the costs of the gas production business between 1954 and 1959, the Commission concluded that a 20 cent price in 1954 was comparable to a 24 cent price in 1959. The Commission also gave weight to the fact that most of the gas involved in this case was to be produced offshore or in the inaccessible bayous where drilling operations were much more expensive than on dry land and to the fact that this gas was obtained from deep horizons. It concluded that the proposed price was not "out of line" with either pre-CATCO or current prices in south Louisiana. Nevertheless, the Commission did issue this warning: "We shall consider any new application based upon a price in excess of any price we have heretofore certificated to be 'out of line' and shall require conclusive proof from the applicant that the public

¹⁴⁸ Texas Gas Transmission Corp., 22 F.P.C. 378 (1959).

¹⁴⁹ *Id.* at 387.

¹⁵⁰ Atlantic Ref. Co. v. Public Serv. Comm'n, 360 U.S. 378 (1959), discussed in text accompanying notes 34 and 99-139 *supra*.

convenience and necessity requires certification at that price.”¹⁵¹ The Commission did not suggest what kind of proof it would regard as “conclusive.”

Rate conditions were attached to permanent certificates for the first time during the post-CATCO—pre-Policy Statement period in the *Transwestern* case.¹⁵² The proposed sales were to be made from what the Commission called the “West Texas-Permian Basin Area” and the “Panhandle-Hugoton Area.” The initial prices provided by some of the contracts were found to be above the highest prices at which previous comparable sales had been made in these areas under Commission certification. It was indicated that if the proposed prices were allowed, consumer gas costs would be increased by eight million dollars. The Commission concluded that the producers had not made a substantial showing that these prices were required by the public convenience and necessity. In reaching this conclusion, the Commission stated that the following factors had been taken into account: (1) the increasing demand for gas in the purchaser’s proposed markets, (2) the present trend of the markets in the purchaser’s gas supply areas and the existing certificated prices in those areas, (3) the quantities of reserves committed under the producers’ contracts and the quality and delivery conditions of the gas, (4) the depth of the producing areas and such evidence of costs as was presented at the hearing.

In imposing price conditions in this case, the Commission recognized that a difference in value existed between gas which must be treated by the purchaser before it is taken into its system and gas which is ready to be taken without further treatment (*i.e.*, pipeline quality gas). It was noted that gas to be sold at 12 cents per Mcf required treatment by the purchaser at a cost of between 4 cents and 8 cents per Mcf. The 12-cent price proposed for this untreated gas, therefore, was held to be above the area “line” of 16 cents per Mcf for “pipeline quality” gas. The Commission took administrative notice of the price at which other sales of gas with the same impurities had been made from the same field and conditioned the certificates covering the sale of the gas in question upon the reduction of the initial price from 12 cents to 11 cents per Mcf.

With respect to the other sales, the Commission ordered that contract prices be reduced to the highest prices for which gas was being sold in the area under comparable circumstances pursuant to Com-

¹⁵¹ 22 F.P.C. at 388.

¹⁵² *Transwestern Pipeline Co.*, 22 F.P.C. 391 (1959), *modified, rehearing granted, and proceeding reopened*, 22 F.P.C. 542 (1959), *amended*, 22 F.P.C. 574 (1959), *on rehearing*, 28 F.P.C. 109 (1962).

mission certificates. The Commission did not regard lower prices in the area as being the "line" to which the proposed prices should be reduced. In this connection, the Commission said: "Since lower prices being paid for gas in the Panhandle-Hugoton area apparently are not conducive to drilling the deep wells required to develop the large reserves being discovered and to bringing this gas to market in large quantities, we look to the recent prices in this area in determining the price condition to be imposed on the certificates in these dockets."¹⁵³

The rate conditions imposed in this case specifically required the producers to file contract amendments with the Commission reducing initial prices to the levels specified by the Commission. Upon commencement of the sales at these reduced prices, the producers were to be free to file price increases up to the original contract level. The producers, however, were required to agree that they would not move to put the increased prices into effect until a section 4(e)¹⁵⁴ proceeding had been held and the justness and reasonableness of such increased prices had been determined.

Subsequent to its original order in this case, the Commission deleted that part of the rate condition dealing with increases and reopened the record for presentation by the producers of further evidence, "including evidence of costs," in support of their contract prices.¹⁵⁵ The Commission stated that in order for the producers to sustain their contract prices, "the evidence must be as convincing as it would be in a rate proceeding under Section 4(e), although it may be of somewhat different character."¹⁵⁶ By another order,¹⁵⁷ the Commission provided that the price levels established by its original order would not be reduced as a result of the reopened proceedings. These price levels were not changed by the final order in the reopened case.¹⁵⁸

In the *Huber* case,¹⁵⁹ the value of a producer's *compressing and gathering* gas was considered by the Commission in issuing certificates without price conditions. The producer proposed to sell gathered gas at a pressure of 45 pounds for 16 cents per Mcf or to sell gathered gas at a pressure of 250 pounds for 18 cents per Mcf. It was decided that the alternative proposals were roughly equivalent from the standpoint of cost to the ultimate consumer. Based upon evidence of record, the Commission found that the cost of gas gathering experi-

¹⁵³ 22 F.P.C. at 400.

¹⁵⁴ 52 Stat. 822 (1938), as amended, 15 U.S.C. § 717c(e) (Supp. IV, 1962).

¹⁵⁵ 22 F.P.C. 542, 544 (1959).

¹⁵⁶ 22 F.P.C. at 544.

¹⁵⁷ 22 F.P.C. 574 (1959).

¹⁵⁸ 28 F.P.C. 109 (1962).

¹⁵⁹ *J. M. Huber Corp.*, 22 F.P.C. 338 (1959).

enced by the purchaser in the same field from which the proposed sale was to be made was 2.71 cents per Mcf. Therefore, a 16-cent price for gathered gas was equated with a 13.29 cent price for gas delivered at the wellhead and, hence, was within the "line" of 16-cent, 16.5-cent, and 17-cent prices existing under certificated wellhead sales in the area. The Commission also ruled in this case that a showing of "need" for the gas on the part of the purchaser was not essential to support the application of the producer.

In another decision,¹⁶⁰ the *depth of the producing formations* was an important factor in the Commission's certification of sales from the Knox field in southern Oklahoma at a price "considerably higher" than that paid by the purchaser for its other gas supplies and well above the highest previously certificated price in the immediate vicinity of these sales. The Commission noted that the evidence showed that the gas would be produced from formations 15,000 to 16,000 feet deep, and it stated that although the price was higher than others paid by the purchaser, the cost of drilling and developing at those depths was also considerably higher. In view of this situation, the Commission concluded: "To encourage and enable producers to explore for and develop gas from these deeper formations, they must have the price necessary to support production from such formations."¹⁶¹ The Commission's "primary criterion" for authorizing this sale at the contract price was said to be higher cost resulting from greater depth of the producing formation. A warning was issued that "any price sought to be justified solely by comparison to the initial price permitted herein must be supported by the same criterion."¹⁶²

The weight given to higher cost resulting from greater depths as a justification or "reason why" in support of a price which apparently otherwise would have been found to be "out of line" is striking in view of the absence of cost evidence in the record. The Commission apparently relied upon its own knowledge of the obvious principle that deeper drilling necessarily results in higher drilling costs. It made no effort to assess the amount of the cost increase which would result from deeper drilling or to relate this cost increase to the size of the reserves found at these depths in order to arrive at a cost increase in cents per Mcf resulting from the greater depth of the producing horizons. Apparently it was the Commission's view that, all other factors being equal, a higher price was justified for gas produced from deep horizons than for gas produced from shallow hori-

¹⁶⁰ Phillips Petroleum Co., 22 F.P.C. 528 (1959).

¹⁶¹ *Id.* at 529.

¹⁶² *Ibid.*

zons. The method employed in determining how much higher the price for deeper gas should be was left unclear.

The Commission's approval of the proposed contract price in this case also was based on another factor. The price in question would be paid in any event for fifty per cent of the Knox field gas by an *intrastate* purchaser; and if acceptable certificates were not issued to the producers and the interstate purchaser within a fixed time, all of the gas would go to the intrastate purchaser at that price. The intrastate purchase would trigger "favored nations" clauses in other contracts of both the intrastate and interstate purchasers in the area and thus would establish a new plateau for producer prices regardless of what action the Commission might take on the applications before it. Although the Commission previously had given passing notice to intrastate sales in issuing producer certificates, this decision was the first instance in which any real weight was given to the existence of unregulated competitive markets as a price justification.

In another case during this period,¹⁶³ the Commission imposed a price condition below the contract price but above the highest previous price which it found in the area. The Commission allowed this increment over the "line" on the basis of its conclusion that *the cost of developing the field* from which the proposed sales were to be made would probably be higher than those incurred in developing the older fields (sales from which were used as a basis of comparison). This conclusion was apparently based on the Commission's awareness of generally increasing costs experienced by gas producers in recent years. The Commission was again quite vague in its rationale and did not say how it arrived at a proper price increment to compensate the producers for these increased costs.

As an additional reason for its allowance of an above-the-line price, the Commission pointed to *the "exceptional advantages" to the purchaser* of acquiring this particular gas supply.¹⁶⁴ The general area from which the proposed sales were to be made had been the principal source of supply for the segment of the purchaser's system into which the gas was to be delivered. Because recent discoveries had been few, the purchaser had experienced a steady decline in reserves available to it in this area. The acquisition of the gas reserves involved in this case would permit continued economic utilization of the purchaser's facilities in the area. The Commission also regarded this gas as particularly valuable to the purchaser because it was located

¹⁶³ Phillips Petroleum Co., 22 F.P.C. 694 (1959), *clarified*, 22 F.P.C. 1021 (1959).

¹⁶⁴ *Id.* at 696.

only a short distance from the purchaser's main line transmission facilities.

In a subsequent order clarifying its decision in this case,¹⁶⁵ the Commission considered the *proper delineation of the area* within which prices should be compared. The proposed prices in this case had been compared only with prices in Texas Railroad District No. 6. In petitions for modification of the original order, the producers had argued that Railroad District No. 6 did not constitute a proper area of comparison because of its smallness and peculiar shape. The producers contended (1) that no showing had been made of any relationship between gas prices and the boundaries of this Railroad District, (2) that larger areas had been used by the Commission in making price comparisons in other cases, (3) that gas was being sold to the same purchaser elsewhere on its system under Commission certificates at prices above the proposed contract price, and (4) that the Commission had certificated sales at prices above the proposed contract price within a distance from the field involved in this case equal to the distance to the farthest point of Railroad District No. 6.

These arguments were rejected by the Commission. It conceded that it had approved sales at prices above the proposed contract price "two hundred miles or so distant" from the field involved in this proceeding.¹⁶⁶ The Commission stated, however, that these sales were from areas in which price differentials had prevailed historically and that if comparable prices were to be allowed for this sale, they must be justified by evidence of record, which the Commission found lacking. Pricing areas utilized in other cases were regarded as having "no bearing on what is the best pricing area for purposes of deciding the instant case involving gas produced in a totally different section of the country."¹⁶⁷

The rate condition imposed in this case required the producers to file within a prescribed period "rate schedules or supplements thereto" providing for the initial rate specified by the Commission.¹⁶⁸ In its clarifying order, the Commission stated that it intended to require amendment of the initial price provisions of the sales contracts, but that it did not intend to require any change in the price escalation and redetermination provisions of the contract.¹⁶⁹

In one case during this period¹⁷⁰ effect was given to a test prescribed

¹⁶⁵ 22 F.P.C. 1021 (1959).

¹⁶⁶ *Id.* at 1022.

¹⁶⁷ *Ibid.*

¹⁶⁸ 22 F.P.C. at 698.

¹⁶⁹ 22 F.P.C. at 1022.

¹⁷⁰ Western Natural Gas Co., 23 F.P.C. 332, 11 O. & G.R. 1074 (1960).

in CATCO¹⁷¹ other than the "out of line" test. There, although evidence was presented that other sales in the area had been made at the proposed initial price, none of the sales relied upon had been made to the purchaser to whom the gas in question was to be sold. These facts, concluded the Commission, gave rise to an inference that the proposed price was higher than other certificated sales in the area to the purchaser in question and, if approved, might result in an increase in the purchaser's existing rates by reason of "favored nation" clauses. Evidence to rebut this inference was held by the Commission to be "an essential part of the applicant's case."¹⁷² Such evidence being absent in this case, the Commission said it could neither issue certificates at the price proposed nor rationally impose a price condition. Accordingly, the applications were denied. This action was taken even though the proposed initial price was apparently not "out of line" as that test then was being applied.

In the *Aneth field* case,¹⁷³ the Commission was confronted with another new problem. The sales proposed were *the first interstate gas sales* from the State of Utah, and considerable ingenuity was required to construct an appropriate price "line" against which to measure the proposed prices. The solution arrived at by the Commission was to look beyond the boundaries of Utah more than seventy-five miles to sales from the San Juan field in New Mexico. Going *outside* the record, the Commission determined from evidence presented in a rate case involving the purchaser that its weighted average gas cost at the wellhead in the San Juan field during 1955 was 11.69 cents per Mcf. To this figure the Commission added a 1-cent price escalation which took place under the purchaser's San Juan contracts on January 1, 1959, and a 5-cent adjustment representing the cost of processing and gathering the Aneth gas, which was to be performed by the producers.¹⁷⁴ The Commission required that the proposed 20-cent initial price be reduced to the 17.7-cent figure so determined.¹⁷⁵

In denying rehearing,¹⁷⁶ the Commission, having derived a price "line" to an exactness of one-tenth of one cent, declared that it could not determine a proper initial price in a certificate case "with the same degree of refinement" as it could in a rate case. The Commission

¹⁷¹ *Atlantic Ref. Co. v. Public Serv. Comm'n*, 360 U.S. 378 (1959), discussed in text accompanying notes 34 and 99-139 *supra*.

¹⁷² 23 F.P.C. at 332, 11 O. & G.R. at 1076.

¹⁷³ *El Paso Natural Gas Co.*, 23 F.P.C. 369, 11 O. & G.R. 889 (1960), *aff'd sub nom. Texaco, Inc. v. FPC*, 290 F.2d 149 (5th Cir. 1961).

¹⁷⁴ The derivation of this cost figure is not apparent from the decision.

¹⁷⁵ The conditions imposed required the producers to file "rate schedules or supplements thereto" reflecting the reduced figure. 23 F.P.C. at 380, 11 O. & G.R. at 902.

¹⁷⁶ 23 F.P.C. 610 (1960).

rejected the argument that cost evidence was necessary to support the price condition it had determined, saying that although cost evidence suitable for determining just and reasonable rates could be relevant in some certificate cases, such evidence was not necessarily indispensable in *every* case.

Diversion of gas from the interstate to the intrastate market, which had been suggested in the *CATCO* case,¹⁷⁷ and which was a real possibility in the *Knox field* case,¹⁷⁸ became a reality in the *Glick field* case.¹⁷⁹ The producers originally contracted to sell the gas to an interstate pipeline company at an initial price of 20 cents per Mcf. The hearing examiner ordered that certificates be issued conditioned upon reduction of the initial price to "the highest prevailing previously authorized price level" in Kansas and northern Oklahoma, which he found to be 16 cents per Mcf. The Commission, however, found the proper price level to be 17 cents per Mcf, based upon sales at that price from northern Oklahoma which the examiner had dismissed as "immaterial" because they represented only a small part of the total gas sold in the area of comparison and because they were approved in shortened, noncontested proceedings. But the Commission also ordered the elimination of an upward price adjustment for gas having a heating value above 1000 Btu's per cubic foot, even though the sales used as a basis for comparison contained the same provision.

In disagreeing with the hearing examiner, the Commission stated that *CATCO*¹⁸⁰ did not require it to "freeze" prices at existing levels, but did "preclude the issuance of certificates at prices higher than those established in recent proceedings unless the applicants have clearly shown that such higher prices are required by the public convenience and necessity."¹⁸¹ Producer evidence showing strong competition for this gas, with bids as high as 21.5 cents, was deemed insufficient for this purpose. Because these prices were not related to the producers' revenue requirements and had been negotiated in what the Commission called a "seller's market," they were held to have "little value as an index of the economic conditions of the gas industry or the needs of a particular producer."¹⁸²

Also rejected as insufficient to justify the proposed price was evi-

¹⁷⁷ *Atlantic Ref. Co. v. Public Serv. Comm'n*, 360 U.S. 378 (1959), discussed in text accompanying notes 34 and 99-139 *supra*.

¹⁷⁸ *Phillips Petroleum Co.*, 22 F.P.C. 528 (1959), discussed in text accompanying and following notes 160-162 *supra*.

¹⁷⁹ *Gulf Oil Corp.*, 23 F.P.C. 664 (1960), *rescinded*, 23 F.P.C. 926 (1960).

¹⁸⁰ *Atlantic Ref. Co. v. Public Serv. Comm'n*, 360 U.S. 378 (1959), discussed in text accompanying notes 34 and 99-139 *supra*.

¹⁸¹ 23 F.P.C. at 666.

¹⁸² *Ibid.*

dence of general industry trends showing increasing costs and decreasing profits; this evidence was regarded as too general to support a particular price. Little weight was given to producer testimony that a 20-cent price was required as an incentive to further development of the Glick field, in view of the rapid development of a field in northern Oklahoma which had taken place at a 17-cent price.

The producers involved in this case rejected¹⁸³ the rate-conditioned certificates.¹⁸⁴ The gas was taken off the interstate market and subsequently was sold in intrastate commerce for use as boiler fuel under 20-year contracts providing for an initial price of 18.5 cents and for escalations up to 20.5 cents.¹⁸⁵

Periodic price increases were the subject of Commission scrutiny in the *Peoples* case.¹⁸⁶ In support of their proposed 20-cent initial price, the producers relied upon the Commission's certification of sales at that price in the *Trunkline* case,¹⁸⁷ even though the proposed contracts provided for a 2-cent price increase every four years while those in *Trunkline* had called for a firm price for ten years. The producers attempted to support these escalations by showing that before delivery the gas would be gathered, dehydrated, and compressed by the producers, whereas in *Trunkline* these functions were to be performed by the purchaser. However, the Commission refused to accord any weight to this difference in services performed because the value of the products derived from processing was expected to exceed the cost of processing. The certificates were issued upon the condition that the contracts be amended to provide for no price escalations for ten years.

In the *Peoples* case, the Commission again relied on political boundary lines to define appropriate areas of price comparison. The sales in question were to be made from Texas Railroad Districts 2, 3, and 4. Upon filing of petitions for rehearing by the producers from the order first issued in the case, the Commission belatedly discovered that the sales involved in the *Trunkline* case had been limited to District 3. Accordingly, it amended its original order¹⁸⁸ to provide that the

¹⁸³ 23 F.P.C. 926 (1960).

¹⁸⁴ The condition attached to these certificates specifically required amendment of the gas sales contracts. 23 F.P.C. at 668.

¹⁸⁵ Foster Associates Report, June 30, 1960, p. 1.

¹⁸⁶ *Peoples Gulf Coast Natural Gas Pipeline Co.*, 24 F.P.C. 1, 12 O. & G.R. 785 (1960), amended, 24 F.P.C. 106 (1960), *set aside sub nom.* *Hassie Hunt Trust*, 26 F.P.C. 689 (1961), *order setting original order aside aff'd sub nom.* *Hunt Oil Co. v. FPC*, 334 F.2d 474 (5th Cir. 1964).

¹⁸⁷ *Trunkline Gas Co.*, 21 F.P.C. 704, 10 O. & G.R. 343 (1959), *aff'd on another ground sub nom.* *Battle Creek Gas Co. v. FPC*, 281 F.2d 42 (D.C. Cir. 1960), discussed in text accompanying notes 86-98 *supra*.

¹⁸⁸ 24 F.P.C. 106 (1960).

price for gas to be sold from Districts 2 and 4 be reduced to 18 cents, the highest price previously found to be required by public convenience and necessity in those districts.¹⁸⁹ Specific cost evidence presented by the producers which indicated a minimum cost of 35 cents per Mcf for this gas was given no weight. The Commission said that even if these figures were correct, it could not hold that such expensive gas was required at that time by the public convenience and necessity.

Subsequently the Commission set aside its order in this case¹⁹⁰ as a result of judicial reversal of its denial of intervention to the New York Public Service Commission.¹⁹¹ The applications were reheard, and a final decision was not issued until 1963.¹⁹²

The last significant certificate decision by the Commission during the post-CATCO—pre-Policy Statement period involved proposed sales from central Oklahoma and northern Texas.¹⁹³ The proposed price for the Texas gas did not exceed prices paid under other certificated sales in the same counties, and the Commission had no trouble certifying these sales without attaching rate conditions.

With respect to the Oklahoma gas, for which a 16-cent price was proposed, the hearing examiner had found that the prevailing price in the area which he deemed relevant for purposes of comparison was 11 cents per Mcf, and he had ordered the certificates conditioned to reflect this price. The Commission agreed that a 16-cent price was "out of line," but stated that "the problem of initial price cannot be solved by attempting to perpetuate a price level that has become obsolete."¹⁹⁴ In disregarding 11-cent prices as "obsolete," the Commission observed that Oklahoma was an area in which gas prices were depressed and that most of the 11-cent gas was produced in conjunction with oil from shallow wells. In arriving at 15 cents as the permissible initial price in this case, the Commission gave weight to the *strong intra-state competition* for gas in this area at a price of 16.8 cents per Mcf; to the relatively *great depth* of the gas involved in this case; and to interstate certificated prices of 17 cents in northwestern Oklahoma, 16.8 cents in the Knox field, Oklahoma,¹⁹⁵ and 15 to 15.5 cents

¹⁸⁹ See Texas-Illinois Natural Gas Pipeline Co., 22 F.P.C. 979 (1959).

¹⁹⁰ Hassie Hunt Trust, 26 F.P.C. 689 (1961), *aff'd sub nom.* Hunt Oil Co. v. FPC, 334 F.2d 474 (5th Cir. 1964).

¹⁹¹ Public Serv. Comm'n v. FPC, 295 F.2d 140 (D.C. Cir. 1961), *cert. denied*, 368 U.S. 948 (1961).

¹⁹² Hassie Hunt Trust, 30 F.P.C. 1438 (1963), *rehearing denied*, No. 412A, FPC, January 24, 1964, discussed at text accompanying notes 339-347 *infra*.

¹⁹³ Natural Gas Pipeline Co. of America, 24 F.P.C. 222 (1960), *amended*, 24 F.P.C. 305 (1960).

¹⁹⁴ *Id.* at 227.

¹⁹⁵ See Phillips Petroleum Co., 22 F.P.C. 528 (1959), discussed in text accompanying and following notes 160-162 *supra*.

per Mcf in southern Oklahoma.¹⁹⁶ The Commission ruled that in a case, such as the instant case, in which comparative price evidence was available, cost evidence was not required.

(2) *Judicial Reaction* During the post-CATCO—pre-Policy Statement period, the Commission had little additional judicial guidance. Shortly before the Commission issued its first orders interpreting and applying CATCO,¹⁹⁷ the Court of Appeals for the Third Circuit affirmed the Commission's pre-CATCO decision in the *Transco* case¹⁹⁸ issuing unconditioned certificates covering sales from south Louisiana and offshore areas at prices ranging from 22.4 to 23.3 cents per Mcf.¹⁹⁹ In substance, the court held, with CATCO before it, that the Commission had not abused its discretion in failing to attach rate conditions to the producer certificates. The court likened the Commission's task of balancing the weight to be given various factors in a certificate case to that of a court of equity in deciding whether an injunction should issue in a particular case. Dissenting,²⁰⁰ Judge Hastie did not challenge the view that the Commission's action might have been permissible under the "strictures" of CATCO, but was of the opinion that the Commission should be given an opportunity to reconsider the cases "in the light of" CATCO before the court reached that point.

Thereafter, in a terse per curiam opinion, the Supreme Court granted certiorari, vacated the judgment of the Third Circuit, and remanded the case to that court with directions to remand it to the Commission "for reconsideration and redetermination in the light" of CATCO.²⁰¹ The Supreme Court's action in this case has been referred to on occasion as a reversal of the Commission's order²⁰² and, therefore, as disapproval of all that the Commission had said and done.²⁰³ Although the correctness of the Commission's *Transco* de-

¹⁹⁶ See *Texas Pac. Coal & Oil Co.*, 22 F.P.C. 1059 (1959).

¹⁹⁷ *Atlantic Ref. Co. v. Public Serv. Comm'n*, 360 U.S. 378 (1959), discussed in text accompanying notes 34 and 99-139 *supra*.

¹⁹⁸ *Transcontinental Gas Pipe Line Corp.*, 20 F.P.C. 264 (1958), *aff'd sub nom. United Gas Improvement Co. v. FPC*, 269 F.2d 865 (3d Cir. 1959), *vacated per curiam and remanded with instructions to remand to Commission*, 361 U.S. 195 (1959), discussed in text accompanying notes 79-85 *supra*.

¹⁹⁹ *United Gas Improvement Co. v. FPC*, 269 F.2d 865 (3d Cir. 1959), *vacated and remanded sub nom. Public Serv. Comm'n v. FPC*, 361 U.S. 195 (1959).

²⁰⁰ 269 F.2d at 869-70.

²⁰¹ *Public Serv. Comm'n v. FPC*, 361 U.S. 195 (1959).

²⁰² *E.g., Callery Properties, Inc. v. FPC*, 335 F.2d 1004 (5th Cir. 1964); *United Gas Improvement Co. v. FPC*, 287 F.2d 159 (10th Cir. 1961); Johnson, *Producer Rate Regulation in Natural Gas Certification Proceedings: CATCO in Context*, 62 Colum. L. Rev. 773, 797 (1962).

²⁰³ "There is reason for belief, because of the action of the Supreme Court in the *Transco* case that the CATCO 'teaching' has not been fully understood and that it has not been applied as the Court may have intended." *Humble Oil & Ref. Co.*, Docket No. G-15227, examiner's decision pp. 5-6, Jan. 29, 1960.

cision may be subject to question in view of several subsequent judicial decisions discussed hereafter, it does not appear that the summary order of the Supreme Court can be construed as either approval or disapproval of the Commission's order issuing unconditioned certificates.²⁰⁴ Since the Commission's order was not vacated, the certificates issued by that order were not vitiated by the Supreme Court's action.²⁰⁵

The Commission's interpretation and application of CATCO²⁰⁶ during the period in question was the subject of a number of judicial decisions. The only Commission order which was affirmed was its issuance of rate-conditioned certificates to the Aneth field producers.²⁰⁷ The court found the Commission's decision to be supported by the record, saying: "The power and duty of the Commission to give 'most careful scrutiny and reasonable [sic] reaction to initial price proposals of producers' may be discharged by it without the elaborate and detailed proofs required in a section 4 or section 5 proceeding."²⁰⁸

The court also upheld the authority of the Commission to impose the kind of rate conditions utilized in this case, viz., that new rate schedules must be filed providing for a reduced price in lieu of the price prescribed by the producer contracts.²⁰⁹ The producers had argued that this action constituted unauthorized rate-making by the Commission and that CATCO²¹⁰ authorized only the kind of rate con-

²⁰⁴ See, e.g., two cases in which certiorari was granted by the Supreme Court, the decisions of the lower courts were vacated, and the cases were "remanded for reconsideration in the light of" cases decided by the Supreme Court subsequent to the decisions of the lower courts; the lower courts reaffirmed their original decisions on remand, and the Supreme Court subsequently denied certiorari on one and affirmed the other. *United States v. Joines*, 246 F.2d 278 (3d Cir. 1957), *cert. granted, judgment vacated, and case remanded*, 357 U.S. 573 (1958), *on remand, original judgment reaffirmed*, 258 F.2d 471 (3d Cir. 1958), *cert. denied*, 358 U.S. 880 (1958); *Barenblatt v. United States*, 240 F.2d 875 (D.C. Cir. 1957), *cert. granted, judgment vacated, and case remanded*, 354 U.S. 929 (1957), *on remand, original judgment reaffirmed*, 252 F.2d 129 (D.C. Cir. 1958), *aff'd*, 360 U.S. 109 (1959).

²⁰⁵ In the remanded proceedings, the Commission treated the originally issued certificates as "still outstanding." *Texaco-Seaboard, Inc.*, 27 F.P.C. 15 (1962). In the same proceedings it stated that a judicial remand after denial of rehearing by the Commission "puts the case in the same posture as if we had initially granted rehearing, subject to any special instructions in the mandate." *Texaco-Seaboard, Inc.*, 27 F.P.C. 482, 483 (1962). Even if the Supreme Court merely had reversed the Third Circuit without specifically prescribing further action by that court, it does not appear that the certificates would have been affected thereby. See *FCC v. Allentown Broadcasting Corp.*, 349 U.S. 358 (1955).

²⁰⁶ *Atlantic Ref. Co. v. Public Serv. Comm'n*, 360 U.S. 378 (1959), discussed in text accompanying notes 34 and 99-139 *supra*.

²⁰⁷ *El Paso Natural Gas Co.*, 23 F.P.C. 369, 11 O. & G.R. 889 (1960), *aff'd sub nom. Texaco, Inc. v. FPC*, 290 F.2d 149 (5th Cir. 1961). The Commission's decision is discussed in the text accompanying notes 173-176 *supra*.

²⁰⁸ 290 F.2d at 157.

²⁰⁹ *Id.* at 156.

²¹⁰ *Atlantic Ref. Co. v. Public Serv. Comm'n*, 360 U.S. 378 (1959), discussed in text accompanying notes 34 and 99-139 *supra*.

dition sought to be imposed in that case, which allowed the producers to collect the full contract price subject to an obligation to refund.²¹¹ The court, in rejecting this argument, cited the *Signal* case²¹² and observed that the Commission was authorized to *deny* a certificate for a sale if it deemed the proposed price to be excessive. From the existence of this authority the court reasoned that power to impose a firm price condition—a remedy less harsh than outright denial—also must exist in the Commission: “[W]e conclude that the power of the Commission to condition a certificate is co-extensive with its power to reject or deny a certificate, even though this might make it impossible for a producer ever to get its initial price. . . .”²¹³ However, the court softened its holding on this point by stating that it found no authority that a producer could not file a rate increase up to the contract price immediately after complying with the rate condition.

The Commission suffered reversal at the hands of the courts in four other cases²¹⁴ involving orders issuing unconditioned certificates covering sales from south Louisiana at prices ranging up to 23.8 cents per Mcf.²¹⁵ In each of these cases, the court found insufficient evidence in the record to support the Commission’s finding that the sales in question were required by public convenience and necessity at the initial prices provided by the contracts; therefore, the court vacated or reversed the orders issuing unconditioned certificates and remanded the cases to the Commission for further proceedings.²¹⁶

The first and most significant of these decisions was issued by the Court of Appeals for the Ninth Circuit.²¹⁷ The court held that the

²¹¹ See paragraph in text accompanying notes 109-110 *supra*.

²¹² *Cities Serv. Gas Co., Signal Oil & Gas Co.*, 14 F.P.C. 134, 5 O. & G.R. 428 (1955), *aff’d*, 238 F.2d 771 (3d Cir. 1956), *cert. denied*, 353 U.S. 923 (1957), discussed in text accompanying notes 42-50 *supra*.

²¹³ *Texaco, Inc. v. FPC*, 290 F.2d 149, 156 (5th Cir. 1961).

²¹⁴ *United Gas Improvement Co. v. FPC*, 290 F.2d 133 (5th Cir. 1961), *cert. denied*, 368 U.S. 823 (1961); *United Gas Improvement Co. v. FPC*, 287 F.2d 159 (10th Cir. 1961); *Public Serv. Comm’n v. FPC*, 287 F.2d 146 (D.C. Cir. 1960), *cert. denied*, 365 U.S. 880, 882 (1961); *United Gas Improvement Co. v. FPC*, 283 F.2d 817 (9th Cir. 1960), *cert. denied*, 365 U.S. 879, 881 (1961).

²¹⁵ Discussed in text accompanying notes 147-151 *supra*.

²¹⁶ A certificate apparently is of no further effect upon the reversal or vacation of the order which issued it. See *Ford Motor Co. v. NLRB*, 305 U.S. 364, 375 (1939); *Atlantic Coast Line R.R. v. St. Joe Paper Co.*, 216 F.2d 832 (5th Cir. 1954), *cert. denied*, 348 U.S. 963 (1955); *SEC v. Joiner Leasing Corp.*, 53 F. Supp. 714 (N.D. Tex. 1944). *But cf.* *Capital Transit Co. v. Public Util. Comm’n*, 213 F.2d 176, 195 (D.C. Cir. 1954), *cert. denied*, 348 U.S. 816 (1954). The Commission has taken the view that a certificate is rendered void by judicial reversal or vacation of the order which issued it. *Placid Oil Co.*, 30 F.P.C. 283, 293 (1963), *rev’d on other grounds sub nom. Callery Properties, Inc. v. FPC*, 335 F.2d 1004 (5th Cir. 1964).

²¹⁷ *United Gas Improvement Co. v. FPC*, 283 F.2d 817 (9th Cir. 1960), *cert. denied*, 365 U.S. 879, 881 (1961).

Commission had abused its discretion in issuing unconditioned permanent certificates upon the basis of existing prices which were "under review" and in failing to take account of "tax reimbursement features" in making price comparisons. Accordingly, the court vacated the Commission's order and remanded the matter to the Commission for further proceedings consistent with its opinion.

The court was disturbed by the fact that out of forty-seven producer rate schedules "upon which the Commission may have relied"²¹⁸ in arriving at a price line, thirty-five were under review by the courts or the Commission and, hence, subject to the "hazard" that the certificate might eventually be denied or that rate conditions might be attached.²¹⁹ The court said that reliance upon producer prices under such a "cloud" would constitute an abuse of discretion by the Commission because the foundation of the "line" based on the prices at which the sales were originally certificated might eventually be undermined. The court also feared that the use of "questioned" rates in formulating a "line" might have the "anomalous" effect of creating a standard by which such questioned rates themselves would be later judged.

The court went a step further and held that not only prices under court or Commission review, but also "like prices" in the same area should be treated as "suspect" if the number of certificated prices in the area under court or Commission review is substantial, "except upon evidence and findings to the effect that they are not subject to the same infirmities which are under test in the pending proceedings."²²⁰ The court also stated that if denial of the right to intervene in certificate proceedings is being tested in the courts, the prices certificated in those proceedings should not be utilized in measuring the area price "line." However, it was held that mere denial of participation in a prior proceeding to a would-be intervener does not preclude use of the price certificated in that proceeding in fixing a price line, if the denial of participation was not challenged judicially. If not judicially challenged, the court observed, the Com-

²¹⁸ *Id.* at 824. The Commission's order did not reveal what producer price schedules actually were relied on by the Commission in finding a 21.5-cent "line". The 47 alluded to in the court's order were appended to the Commission's brief before the court and the list was said to be "not exhaustive."

²¹⁹ Thirty-one schedules were before the Commission again on remand from the Third Circuit in the *Transco* case, discussed in text accompanying note 79-85 *supra*. The other four rate schedules were affected by a pending petition to review the Commission's denial of intervention to the New York Public Service Commission in the *Trunkline* case, discussed in text accompanying notes 86-98 *supra*. This "hazard" was subsequently dissipated when the petition for review was dismissed. *Public Serv. Comm'n v. FPC*, 284 F.2d 200 (D.C. Cir. 1960).

²²⁰ *United Gas Improvement Co. v. FPC*, 283 F.2d 817, 824-25 (9th Cir. 1960).

mission's order excluding participation by others must be taken as correct.

The court also concluded that the Commission erred in looking only to base prices, exclusive tax reimbursement, in determining whether the prices in question were "out of line." Although it recognized that taxes paid by a producer were an out-of-pocket cost and that reimbursement for these taxes did not amount in itself to a gain by the producer, nevertheless, the court noted that tax reimbursement was an item of bargaining between sellers and buyers of gas and concluded that a producer who bargained for a full tax reimbursement had obtained a better price than one who bargained for only a partial tax reimbursement. For this reason, the court held that the Commission should take comparative tax reimbursement provisions into account as well as comparative prices in determining whether a proposed initial price is "out of line."²²¹

CATCO²²² was read by the court as permitting the issuance of unconditioned certificates only if the Commission found upon substantial evidence (1) that the price was not "out of line" or that if "out of line," the prices were required by public convenience and necessity (*i.e.*, a "reason why") and (2) that the approval of the price would not trigger general price rises or cause an increase in the existing rates of the purchaser. The "'hold the line' technique" was described as a "stopgap device" designed to serve the public interest in obtaining both reasonable rates and expeditious dedication of needed new gas reserves. This device was seen by the court as a means of affording "standby protection to the public pending normal rate adjudicatory proceedings while enabling the Commission to act upon certificate applications with reasonable dispatch."²²³

In vacating the Commission's order and remanding the case for further proceedings, the court commented at length upon the proper determination of the price "line" and upon the evidence which should be presented in a certificate proceeding. On the proper construction of the "line," the court said:

[T]he "line" referred to in Catco may properly be referenced to *relevant existing producer prices under which substantial amounts of natural gas move in interstate commerce* Where there are no *relevant* existing producer prices with which a price proposal may be compared, Catco indicates the best criterion of a proper price line may be the

²²¹ If tax reimbursement is considered a part of the purchase price, the highest price involved in this case (23.8 cents) was .25 cent higher than the highest price previously certificated by the Commission in south Louisiana.

²²² *Atlantic Ref. Co. v. Public Serv. Comm'n*, 360 U.S. 378 (1959), discussed in text accompanying notes 34 and 99-139 *supra*.

²²³ 283 F.2d at 823.

applicant's²²⁴ prices elsewhere, *qualified where necessary by substantial evidence explaining price differentials.*

Existing producer prices are *relevant* for comparative purposes *only if they pertain to gas production in the same or an analogous area and if other principal features of the contracts are fairly comparable.* Thus the contracts should be comparable from the standpoint of gas reserves and *future potentials.* The significance of any disparities existing as to these conditions should be explained by Commission findings based upon substantial evidence. Substantial variation in the *quality of gas* sold should be similarly treated. . . . Disparate provision relative to *facilities to be provided* and other *services to be rendered* should be given effect as well in determining the propriety of the analogy to rates under other existing contracts.²²⁵ (Emphasis added.)

The court held that the Commission correctly considered prices paid by *all* pipelines in the area instead of only those paid by the particular pipeline to which the proposed sales were to be made.

The court said that factors such as relative production costs which are not reflected in specific terms of the contracts need not be examined in determining relevancy for comparative purposes, but conceded that if no comparable prices were available, such considerations as relative production costs, need, competition, and other factors would become significant. Specifically rejected by the court was a contention that the price "line" of necessity must be identical to the pre-CATCO "line." The court agreed with the view expressed by the Commission in the *Texas Gas* case²²⁶ that factors such as increased production costs, comparative accessibility of field locations, and comparative depth of sands tend to make pre-CATCO prices irrelevant for comparative purposes in other cases. It further held that in determining the "line," the Commission could properly look to certificated sales even though the price had not been "scrutinized" by the Commission. Otherwise, it was observed, the "line" would not reflect current conditions in the industry, and a rollback to prices having no current relevancy might be required.

The court ruled that a "comprehensive showing," appropriate in a rate case, was not required in a certificate case. The court also commented on the evidence which should be adduced in a certificate case:

[W]here the Commission relies upon existing certificated rates in establishing a line, evidence ought to be submitted concerning those rates. The contracts ought to be identified, and each should be subject to test as to arms-length bargaining, identity or similarity of gas pro-

²²⁴ This word apparently refers to the purchaser.

²²⁵ 283 F.2d at 823.

²²⁶ Discussed in text accompanying notes 148-151 *supra*.

duction area, nature of gas reserves, quality of gas, facilities to be provided and services to be performed.²²⁷

The decision of the Ninth Circuit set the pattern for the other three decisions rejecting the Commission's initial application of CATCO²²⁸ in south Louisiana. Thus, the District of Columbia Circuit²²⁹ refused to give weight to the fact that the prices involved in the case before it were in keeping with numerous other certificated sales in the area, saying:

We are . . . reluctant to endorse so dubious a standard of reference, since *presumably* the high price certifications which followed in the wake of the Commission's Catco certification are as much subject to explanation as the Catco price itself. Where the inquiry is whether a particular proposed price is inflated, it serves no purpose to refer to other prices which may be equally inflated.²³⁰ (Emphasis added.)

The court went further and found in CATCO "an interpretation of the 'public interest' which, in the context of a rising natural gas market, demands a real administrative effort to hold back prices."²³¹

The Tenth Circuit²³² was particularly influenced by the Supreme Court's action in the *Transco* case²³³ (which it called a "summary reversal") because the sales involved in the case before it were to be made from the same field as were the sales in *Transco*. The court concluded that it would be "presumptuous" on its part to hold that the price involved in the case before it was "in line" and consistent with public convenience and necessity. This court also treated prices involved in applications pending on review before the courts or the Commission as "suspect" and said that this situation would prevail until final disposition was made of the applications involved in CATCO and *Transco*. Weight was given to the failure of the Commission in its Statement of General Policy No. 61-1²³⁴ to list initial price levels for south Louisiana. This omission was said to be an "implied admission by the Commission" that it had not determined the "line" in the area.²³⁵ The court also noted that in its Policy State-

²²⁷ 283 F.2d at 826.

²²⁸ *Atlantic Ref. Co. v. Public Serv. Comm'n*, 360 U.S. 378 (1959), discussed in text accompanying notes 34 and 99-139 *supra*.

²²⁹ *Public Serv. Comm'n v. FPC*, 287 F.2d 146 (D.C. Cir. 1960), *cert. denied*, 365 U.S. 880, 882 (1961).

²³⁰ 287 F.2d at 149.

²³¹ *Id.* at 150.

²³² *United Gas Improvement Co. v. FPC*, 287 F.2d 159 (10th Cir. 1961).

²³³ *Public Serv. Comm'n v. FPC*, 361 U.S. 195 (1961), discussed in text accompanying notes 201-205 *supra*.

²³⁴ 24 F.P.C. 818, 12 O. & G.R. 1227 (1960), *appeal dismissed sub nom. Wisconsin v. FPC*, 292 F.2d 753 (D.C. Cir. 1961), discussed in text accompanying notes 245-259 *infra*.

²³⁵ *United Gas Improvement Co. v. FPC*, 287 F.2d 159, 162-63 (10th Cir. 1961).

ment amendment prescribing initial prices for south Louisiana, the Commission specifically said that it was not prejudging cases being reconsidered by it on remand.

The Fifth Circuit²³⁶ also quoted with approval that portion of the Ninth Circuit's opinion condemning the use of challenged prices in finding an acceptable price level. Unlike the other three courts, however, this court seemed to equate the standard applicable in certificate cases with the "just and reasonable" standard applicable in rate cases under sections 4 and 5 of the act.²³⁷ The court was troubled by the fact that new "initial filing prices" were allowed to be "fixed" at levels well above those at which the Commission was suspending rate increases under old contracts, upon the basis of evidence of arm's length bargaining and field price evidence which had been held insufficient to show the justness and reasonableness of price increases.

In a well-written dissenting opinion,²³⁸ Judge Brown condemned the approach of the majority and of the other three courts which had found the Commission's application of the "out of line" test wanting. He saw in *CATCO*²³⁹ "no purpose . . . to make the section 7 public convenience standard one merely of a simple arithmetical inquiry: is this price higher?"²⁴⁰ He reasoned that prices "may be higher and yet quite 'in line'" and concluded that what is "out of line" is a matter for the judgment of the Commission.²⁴¹ Noting that *CATCO* does not spell out what the "line" is or how the Commission is to determine it, he said: "The term 'out of line'—nowhere found in the Natural Gas Act—is a handy colloquialism which, if it means anything at all, must convey the connotation of the more familiar term 'abuse of discretion'—*i.e.*, is the proposed increase so great as to indicate arbitrary action without reasonable support in the practicalities of the regulated gas industry?"²⁴²

Judge Brown also addressed himself to the proposition that challenged orders of the Commission should not be relied upon in determining the "line":

Nothing under [section] 19(b) of the Act makes FPC action a nullity while it is being challenged in court. The record of this Court in denying application of stay in rate orders shows that we regard Commission

²³⁶ *United Gas Improvement Co. v. FPC*, 290 F.2d 133 (5th Cir. 1961), *cert. denied*, 368 U.S. 823 (1961).

²³⁷ 52 Stat. 822 (1938), as amended, 15 U.S.C. §§ 717c-717d (1958).

²³⁸ 290 F.2d at 138.

²³⁹ *Atlantic Ref. Co. v. Public Serv. Comm'n*, 360 U.S. 378 (1959), discussed in text accompanying notes 34 and 99-139 *supra*.

²⁴⁰ 290 F.2d at 141.

²⁴¹ *Ibid.*

²⁴² *Ibid.*

decisions as of continuing vitality unless some strong circumstance compels holding them in abeyance . . . Just what is there about this which withholds the imprimatur of the law until the judge has spoken? Does the whole machine stop when an appeal is taken?²⁴³

He concluded that in disturbing the Commission's judgment in this case the court had only succeeded in adding to the Commission's already staggering workload and that: "I am confident of only one thing: this case will be back several years and thousands of pages later. No one will know more than is known now."²⁴⁴

d. Policy Statement

September 28, 1960, marked the beginning of a new era in the Commission's approach to the rate issue in producer certificate cases. On that day the Commission rendered its long-awaited decision in the *Phillips* rate case.²⁴⁵ In that case it held that "the traditional original cost, prudent investment rate base method of regulating utilities is not a sensible or even a workable method of fixing the rates of independent producers of natural gas"²⁴⁶ and announced its intent "to establish fair prices for the gas itself" upon the basis of the "reasonable financial requirements of the industry."²⁴⁷

On the same day that it decided *Phillips*, the Commission issued Statement of General Policy No. 61-1²⁴⁸ in which it prescribed "rate standards for independent producers of natural gas" that were set forth in a schedule of "maximum acceptable rates" for twenty-three gas producing areas. Two rates were announced for each area, one being applicable to "initial prices in new contracts" and the other to "escalated prices in existing contracts."²⁴⁹ These rates were said

²⁴³ *Id.* at 140-41.

²⁴⁴ *Id.* at 147. In 1964, the case was again before the Fifth Circuit, which, in an opinion by Judge Brown, again reversed the Commission and remanded the case for failure to receive cost and financial evidence presented by the producers. *Callery Properties, Inc. v. FPC*, 335 F.2d 1004 (5th Cir. 1964), discussed in text accompanying notes 331-337 *infra*.

²⁴⁵ *Phillips Petroleum Co.*, 24 F.P.C. 537, 13 O. & G.R. 343 (1960), *aff'd sub nom. Wisconsin v. FPC* 303 F.2d 380 (D.C. Cir. 1961), *aff'd*, 373 U.S. 294 (1963).

²⁴⁶ 24 F.P.C. at 542, 13 O. & G.R. at 347.

²⁴⁷ *Id.* at 547, 13 O. & G.R. at 353-54. On the subject of the Commission's abandonment of the cost of service approach in evaluating producer rates, see Orn, *Area Pricing of Natural Gas by the Federal Power Commission*, Oil and Gas Operations: Legal Considerations in the Tidelands and on Land 371 (Slovenko ed. 1963); Orn, *FPC Excursion into New Regulatory Fields*, 14 Ann. Inst. on Oil and Gas Law and Taxation 71 (1963); Ross, *The Area Rate Proceedings: An Unsettled Experiment in Public Control of Natural Gas Prices*, 18 Sw. L.J. 163 (1964); Comment, *The Legality of FPC Regulation of Independent Gas Producers by Area Price Fixing*, 50 Geo. L.J. 250 (1961).

²⁴⁸ 24 F.P.C. 818, 12 O. & G.R. 1227 (1960), *appeal dismissed sub nom. Wisconsin v. FPC*, 292 F.2d 753 (D.C. Cir. 1961).

²⁴⁹ No "standard" for initial prices in Mississippi and south Louisiana was announced. The reason given by the Commission for this omission was that the determination of the proper initial price in those areas was the subject of the remanded *CATCO* and *Transco*

to be based on the Commission's experience in regulating producers for six years and upon its consideration of all of the "relevant facts" available to it.²⁵⁰ The areas were said to be "convenient and well known" and subject to revision upon the basis of experience and changing factors.²⁵¹ The rates prescribed were stated to be "for the purpose of guidance and initial action by the Commission,"²⁵² to "serve as a guide . . . in determining whether proposed initial rates should be certificated without a price condition and whether proposed changes should be accepted or suspended."²⁵³

The Commission stated unequivocally that its announcement of area rate levels was not a determination of just and reasonable rates and would not foreclose any person from justifying a particular rate in any area. However, the Commission also made it plain that absent "compelling evidence" requiring a different course of action, initial sales at rates above those announced by the Policy Statement would be certificated only upon the condition that initial rates be reduced and rate increases filed under existing contracts to levels above the standards set forth would be suspended. In this connection, the Commission said:

Where a proposed price exceeds the indicated rate level and is therefore conditioned or suspended we will, in determining whether the higher price is justified, not necessarily consider only *the financial requirements of the individual producer* proposing the price but will consider *all of the above elements relevant to the industry generally* in this area concerned. *Similar evidence will also be required from purchasers or their customers who object to any of the price levels or any specific price.*²⁵⁴ (Emphasis added.)

The rate standards were said to be applicable to "pipeline quality gas as that term is generally understood in each area."²⁵⁵ In all areas

cases. Subsequently, however, initial rate "standards" for these areas were set forth in the First Amendment to the Policy Statement. 24 F.P.C. 903, 12 O. & G.R. 1231 (1960), amended, 26 F.P.C. 661, 15 O. & G.R. 413 (1961). See note 258 *infra*.

²⁵⁰ The "relevant facts" which the Commission listed as having been considered were "cost information from all decided and pending cases, existing and historical prices structures, volumes of production, trends in production, price trends in the various areas over a number of years, trends in exploration and development, trends in demands, and the available markets for the gas." 24 F.P.C. at 819, 12 O. & G.R. at 1228.

²⁵¹ *Ibid.*

²⁵² 24 F.P.C. at 819, 12 O. & G.R. at 1229.

²⁵³ 24 F.P.C. at 818, 12 O. & G.R. at 1227.

²⁵⁴ 24 F.P.C. at 820, 12 O. & G.R. at 1229.

²⁵⁵ 24 F.P.C. at 819, 12 O. & G.R. at 1228. Subsequently, in a separate proceeding the Commission gave notice of proposed standards for "pipeline quality gas," and invited comments. 26 Fed. Reg. 4614 (1961). This matter still was pending at the time of this writing. A related proceeding has been instituted concerning the "ultimate propriety" of Btu price adjustments—*i.e.*, price adjustments based on the heating properties of gas. Sunray DX Oil Co., 29 F.P.C. 1079 (1963).

except Louisiana they were inclusive of tax reimbursement but did not reflect contractual provisions such as price adjustments for heating value or point of delivery. Revision of the standards to reflect such adjustments was promised if such adjustments were determined to have "general applicability" in specific areas.

All parties interested in changing any of the announced area prices or geographical pricing areas were invited to join in a proceeding for that purpose. Shortly thereafter, the Commission initiated the Permian Basin Area Rate Proceeding "for the purpose of developing facts relevant and appropriate to the determination of a just and reasonable area producer rate, or rates."²⁵⁶ Specifically excluded from the scope of this proceeding was revision of the Commission's previously announced area boundaries.²⁵⁷

Since its issuance, the Policy Statement has been amended nine times.²⁵⁸ More significant, however, is the change that has occurred during this period in the Commission's application of the Policy Statement and in its general approach to the rate issue in producer certificate proceedings. The Policy Statement rates, originally pre-

²⁵⁶ Area Rate Proceeding, 24 F.P.C. 1121, 1122 (1960). This proceeding covers Texas Railroad Commission Districts 7(c) and 8 and the New Mexico Permian Basin. Subsequent area proceedings have been instituted covering south Louisiana, 25 F.P.C. 942 (1961), the Hugoton-Anadarko Basin (Kansas and Oklahoma), 30 F.P.C. 1354 (1963), and the Texas Gulf Coast (Railroad Districts 2, 3, and 4), 30 F.P.C. 1354 (1963). The examiner's decision in the *Permian Basin* case was issued on September 17, 1964, three years and nine months after the proceeding was initiated. Commission and judicial review remain.

²⁵⁷ Subsequently, in a separate proceeding, the Commission gave notice of proposed new areas and area boundaries and invited comments on these proposals. 27 Fed. Reg. 5714 (1962). This matter has been held in abeyance by the Commission pending further development in the area rate proceedings. 28 Fed. Reg. 12945 (1963).

²⁵⁸ The amendments have been as follows:

1. Prescribed initial rates for south Louisiana and Mississippi. 24 F.P.C. 903, 12 O. & G.R. 1231 (1960).
2. Raised limit prescribed for increased rates in Texas Railroad Districts 2, 3, 4, and 6 with respect to rate schedules from which certain pricing clauses were eliminated. 24 F.P.C. 1107, 14 O. & G.R. 209 (1960), *amended*, 29 F.P.C. 589, 17 O. & G.R. 889 (1963).
3. Increased initial and increased rates prescribed for Texas Railroad Districts 5, 7b, and 9. 25 F.P.C. 595, 14 O. & G.R. 211 (1961).
4. Reduced initial rate prescribed for south Louisiana. 26 F.P.C. 661, 15 O. & G.R. 413 (1961).
5. Reduced initial rate prescribed for Texas Railroad District 4. 28 F.P.C. 441, 16 O. & G.R. 962 (1962).
6. Reduced initial rate prescribed for Texas Railroad District 3. 29 F.P.C. 590, 17 O. & G.R. 894 (1963).
7. Raised limit prescribed for increased rate in all areas except (a) those covered by the Second Amendment, (b) those in south Louisiana, (c) those in the Permian Basin, and (d) those in Texas Railroad Districts 5 and 9, with respect to rate schedules from which certain pricing clauses were eliminated. 30 F.P.C. 1370, 19 O. & G.R. 475 (1963).
8. Reduced initial rate prescribed for Texas Railroad District 2. 28 Fed. Reg. 13547 (1963), 19 O. & G.R. 478 (1963).
9. Limited applicability of Second and Seventh Amendments to situation in which contract constituting rate schedule has at least 5 years of its term remaining. 29 Fed. Reg. 11154 (1964).

scribed as "guidance" levels which would prevail in the absence of "compelling evidence" in support of other rates, have been treated on occasion as establishing the "line" and have become virtually impenetrable "ceilings." The scope of permissible "compelling evidence" which may be adduced in a certificate proceeding in support of an initial price above the applicable area level has been narrowed from evidence relating to the spectrum of factors upon which the Commission said it relied in formulating Policy Statement prices to evidence only of historical price levels existing at the time the contracts in question were executed. This change in approach could be due, in part at least, to the complete change which has occurred in the membership of the Commission since the Policy Statement was promulgated.²⁵⁹

e. *Post-Policy Statement*

(1) *Opinion 339* In its only major certificate decision²⁶⁰ after the issuance of the Policy Statement, the "old" Commission²⁶¹ attached rate conditions to the certificates issued at the levels prescribed in the Policy Statement. The record in the case had been closed prior to the issuance of the Policy Statement, and the producers had presented extensive evidence in support of the proposed 22-cent price; this evidence included costs of production, existing and previous price conditions, volume and conditions of production, extent of reserves, location of fields, conditions of delivery, quality of the gas, and relative need for the gas. Despite this presentation, the Commission applied the Policy Statement price in a most perfunctory manner: "Obviously, under the provisions of the Commission's Policy Statement, as amended, the producers are entitled to no more than 21.5 cents per Mcf . . . exclusive of tax."²⁶² The producers and the pipeline disagreed as to whether the proper amount of tax reimbursement was 1.8 cents or 2.3 cents per Mcf. Without explaining its reasons, the

²⁵⁹ At the time the Policy Statement was issued, the Commission consisted of Chairman Jerome K. Kuykendall, Commissioner Frederick Stueck, and Commissioner Arthur Kline. There were two vacancies. At the time of this writing, the Commission is made up of: Chairman Joseph C. Swidler, who took office on June 28, 1961; Commissioner L. J. O'Connor, who took office on August 14, 1961; Commissioner Charles R. Ross, who took office on September 29, 1961; and Commissioner David S. Black, who took office on August 30, 1963. Commissioner Black replaced Commissioner Howard Morgan, who had taken office on June 28, 1961. The existing vacancy was caused by the death on August 4, 1964, of Commissioner Harold C. Woodward, who had taken office on March 30, 1962.

²⁶⁰ *Trunkline Gas Co.*, 24 F.P.C. 1020 (1960).

²⁶¹ The distinction between the "old" Commission and the "new" Commission was originated by the "new" Commissioners. See, e.g., Address by Chairman Swidler, American Gas Ass'n, October 9, 1962; Address by Commissioner O'Connor, Independent Natural Gas Ass'n, August 27, 1962.

²⁶² 24 F.P.C. at 1038. The condition imposed in this case simply provided that the initial price "shall be 23.25 cents per Mcf, including tax." *Id.* at 1040.

Commission concluded that 1.75 cents per Mcf was the permissible tax reimbursement.

(2) *Opinion 350* After a lapse of over a year in major certificate decisions, the "new" Commission handed down its first decision,²⁶³ in which certificates were issued to producers in the Oklahoma Panhandle and Oklahoma "Other" areas on the condition²⁶⁴ that initial rates be reduced to applicable Policy Statement levels. It refused to depart from these levels (which it called "ceilings"), stating that the Policy Statement should not be construed to suggest that changes in area prices (or boundaries) would be made in individual proceedings. Any such change on an *ad hoc* basis, the Commission warned, would require at least "a very compelling showing."²⁶⁵

The evidence in this case was held to fall short of the requisite "showing." Indeed, the Commission concluded on the basis of evidence of certificated prices in the Oklahoma "Other" area that a reasonable relationship existed between the "line" and the initial rate prescribed by the Policy Statement for that area. Evidence of similarity between the proposed sales from the Oklahoma "Other" area and higher priced sales certificated from the Oklahoma Panhandle area failed to persuade the Commission that the higher price should be allowed in both areas. The Commission revealed that a review of area boundaries was underway²⁶⁶ and provided that any increases in applicable area price levels resulting from such review would inure prospectively to the benefit of producers accepting certificates issued in this case.

The Commission dismissed as unworthy of consideration evidence of factors that affect the desirability of a particular gas supply such as size of reserves and high initial availability of gas. Policy Statement prices were held to contemplate the sale of substantial reserves

²⁶³ Panhandle Eastern Pipe Line Co., 27 F.P.C. 35, 15 O. & G.R. 877 (1962). In an earlier case, the Commission (consisting of two "old" and two "new" Commissioners) had issued an order (1) rescinding unconditioned permanent certificates previously issued by the "old" Commission, and (2) granting new permanent certificates without deciding the initial rate issue. Coastal Transmission Corp., 26 F.P.C. 318 (1961). The producers applied for rehearing urging that a permanent certificate could not be issued consistent with CATCO without determining the initial rate required by public convenience and necessity; the Commission rescinded its order and issued temporary certificates to the applicants. Coastal Transmission Corp., 26 F.P.C. 677 (1961).

²⁶⁴ In this case the condition imposed required the filing of new rate schedules. 27 F.P.C. at 50-51, 15 O. & G.R. at 898-99.

²⁶⁵ *Id.* at 42, 15 O. & G.R. at 887.

²⁶⁶ Subsequently, the Commission gave formal notice of proposed revisions in area boundaries. 27 Fed. Reg. 5714 (1962). Such proposed revisions were said to be based on, *inter alia*, geological considerations (nature, size, and location of production areas) and purchasing patterns in the areas of the major sources of supply. This matter has been held in abeyance by the Commission pending further development in the area rate proceedings. 28 Fed. Reg. 12945 (1963).

as well as gas of "pipeline quality." Further, the Commission said: "Apart from some specific service or forbearance in connection with a sale of gas, or some circumstance with respect to the conditions of its sale which affects its character as pipeline quality gas, *the value of the gas to the pipeline purchaser is not a consideration in the certification of initial prices under our area pricing policy.*"²⁶⁷

One producer, however, was allowed a rate 2.5 cents *above* the Policy Statement level *for services performed beyond the wellhead*. These services consisted of gathering, dehydrating, and compressing the gas; they were found not to be generally performed by producers in this area and, therefore, not to be requisite to make the gas "pipeline quality" as that term was understood in the area. No weight was given to evidence of *the cost saving to the pipeline* resulting from the performance of these services by the producer. It was ruled that the producer's allowance should be based on *the producer's cost of rendering the services*. The Commission found insufficient evidence to determine such costs precisely and, therefore, allowed "an amount which in our judgment is reasonable."²⁶⁸

In this case the Commission's staff had challenged the propriety of contract provisions (1) allowing the producers additional compensation for gas with heating properties over a specified norm and (2) requiring the purchaser to take specified quantities of gas or to pay for it even if not taken. The Commission found that the heating value adjustment would not adversely affect the purchaser's jurisdictional service and allowed the adjustment to be operative pending the outcome of the rule-making proceeding concerning pipeline quality gas.²⁶⁹ An upper limit was imposed on the adjustment with respect to the producer that had been allowed a 2.5-cent service increment, and that producer was required to compute the adjustment on the rate charged, net of such increment. The "take-or-pay" provisions were allowed pending the outcome of another rule-making proceeding which the Commission had initiated concerning their propriety.²⁷⁰

(3) *Opinion 351* The "new" Commission's approach to the rate issue in certificate cases was further developed in the remanded CATCO case,²⁷¹ in which certificates were issued upon the condition

²⁶⁷ 27 F.P.C. at 45-46, 15 O. & G.R. at 891. (Emphasis added.)

²⁶⁸ 27 F.P.C. at 45, 15 O. & G.R. at 891. The Commission expressed satisfaction that the amount allowed could be "readily justified" if additional evidence were taken. *Ibid.*

²⁶⁹ See note 255 *supra*.

²⁷⁰ 26 Fed. Reg. 4615 (1961). The Commission provided that regardless of the outcome of this proceeding the purchaser's obligation would not be reduced below a specified level.

²⁷¹ Continental Oil Co., 27 F.P.C. 96, 15 O. & G.R. 841 (1962), *clarified and rehearing denied*, 27 F.P.C. 592 (1962).

that the initial rate be reduced from 21.4 cents to 18.5 cents²⁷² and that refunds be made of all amounts collected since first deliveries in excess of the amount which would have been collected at 18.5 cents. Because the contracts in question were executed in 1956, prior to the promulgation of the Policy Statement, the Commission applied a method which it said "would not be appropriate where area price levels announced by us are applicable or where area rate proceedings have been held with resulting elimination of the price problem."²⁷³ This method consisted of determining "in liness" *as of the time the contracts in question were executed* and comparing the "line" so determined with evidence of the applicants' cost of service attributable to the gas in question during the first full calendar year of operation. Although it agreed with the examiner's conclusion that the "line" should be determined as of a past period, the Commission did not agree with his technique of adjusting a 1953-1955 "line" on the basis of subsequent cost increases because the field prices to which the examiner applied his cost adjustment factor were not shown to be equivalent to cost.

In ruling that "in liness" should be determined as of the date of the contract, the Commission indicated its concern that the CATCO producers not be "enriched" by procedural delays. The "line" for 1956 was based on prices which had been allowed that year and before, "which were not affected by initial prices which the courts have called into question."²⁷⁴ Reliance was placed on onshore sales although it was admitted that such sales were not completely comparable with offshore sales by the CATCO producers. The Commission analyzed the sales which it relied on by the number in each of the various price ranges and found a weighted average price of 18.59 cents *for interstate gas delivered in 1958 under 1956 contracts*. Although the Commission conceded that initial prices above 20 cents had been provided by 20 out of 290 contracts in the period between the beginning of 1950 and the end of 1956, it ruled that a price "is not in line as of a given time if it is the highest price or in the highest group of prices theretofore paid."²⁷⁵

It appeared for a time that the CATCO case would journey through the courts a second time, as five parties petitioned for judicial review

²⁷² The condition provided that the initial price "shall be" 18.5 cents. 27 F.P.C. at 111. Pending determination of whether offshore zone 3 was within the territorial limits of Louisiana, an additional 1.5 cents per Mcf was allowed to be collected as tax reimbursement for gas produced from that area, subject to an obligation to refund such amounts if the area is determined to be beyond the limits of Louisiana. *Ibid.*

²⁷³ 27 F.P.C. at 100, 15 O. & G.R. at 845.

²⁷⁴ *Ibid.*

²⁷⁵ 27 F.P.C. at 102, 15 O. & G.R. at 848.

of the Commission's order in the remanded proceedings. However, on December 21, 1962, the Commission conditionally approved a settlement of the case,²⁷⁶ and early in 1963 the petitions for review were dismissed and the case was closed when the producers complied with the Commission's conditions to approval of the settlement. Under the terms of the settlement, the CATCO companies were permitted to collect varying prices, ranging from 18.5 cents²⁷⁷ to 19.5 cents in different areas, and were required to make refunds to the purchaser totaling almost 5.7 million dollars, plus interest.²⁷⁸

(4) *Ohio* In another post-Policy Statement decision,²⁷⁹ the Commission approved sales from north Louisiana under contracts executed prior to the Policy Statement on the condition that the initial rates be reduced from 18.5 cents to 17.0 cents and 16.5 cents. The approach to the rate issue in this case was similar to that adopted in the remanded CATCO case.²⁸⁰ Prices under contracts made contemporaneously with those in issue were analyzed, and based on this analysis, a "line" was derived. For reasons not expressed, the Commission broke the period during which the contracts were executed into two parts, and found a 16.5-cent "line" for the earlier part and a 17.0-cent "line" for the later part.²⁸¹ The Commission refused to give controlling effect to one permanently certificated sale at 18.5 cents and gave no consideration to a 21.5-cent sale which provided for a six-year delay in initial deliveries. An "economic study" presented by one producer showing costs of \$5.80 per Mcf for one unit and costs of 7 cents per Mcf for another was deemed to be inconclusive, and evidence of increasing risks in the area was said to be too general to be translated into cost figures for the sales. The delivery pressure requirements under the contracts in question were slightly higher than those under contracts used as a basis of comparison, but this fact was held not to support an upward price adjustment.

The Commission's order in this case was affirmed on appeal.²⁸² The

²⁷⁶ Continental Oil Co., 28 F.P.C. 1090 (1962).

²⁷⁷ The CATCO companies reserved the right to file for a 1.5-cent increase with respect to the sale for which 18.5 cents was allowed, in the event that the area of the sales were determined to be within the taxing jurisdiction of Louisiana.

²⁷⁸ On the same day the CATCO settlement was conditionally approved, a settlement of the purchaser's pending rate case also was approved, requiring that refunds received from the CATCO companies be passed along to the purchaser's customers. Tennessee Gas Transmission Co., 28 F.P.C. 1100 (1962).

²⁷⁹ Ohio Oil Co., 27 F.P.C. 551 (1962), *aff'd sub nom.* Atlantic Ref. Co. v. FPC, 316 F.2d 677 (D.C. Cir. 1963).

²⁸⁰ Continental Oil Co., 27 F.P.C. 96, 15 O. & G.R. 841 (1962), *clarified and rehearing denied*, 27 F.P.C. 592 (1962), discussed in text accompanying notes 271-278 *supra*.

²⁸¹ 17.0 cents was the initial price prescribed for the area by the Policy Statement, but no weight was given to this fact.

²⁸² Atlantic Ref. Co. v. FPC, 316 F.2d 677 (D.C. Cir. 1963).

court stated that the record in this case indicated that the Commission had begun to comply with the Supreme Court's instructions in *CATCO*.²⁸³ The court indicated that the Commission should be allowed some latitude in fixing prices on an area basis and, in this connection, said:

Since there is no mechanism for refund of overcharges under Section 7, *if the Commission is to err in setting an initial rate, it should err on the low side because the company, under Section 4, can immediately increase the rate*, subject to disallowance by the Commission after a full rate proceeding, the public being protected with reference to refunds in the interim.²⁸⁴ (Emphasis added.)

After reviewing the evidence of other prices considered by the Commission, the court concluded that the Commission had not abused its discretion in attaching rate conditions in this case. The 18.5-cent sale to which the Commission refused to give controlling effect was said by the court to be "suspect" because it was subject to a section 5 rate investigation. No evidence was found to support a contention that the appellant's production costs were higher than those of other producers making sales in the area at 16.5 cents. Further, the court concluded that the Commission was not required to subsidize high cost producers with consumers' money.

(5) *Opinions 353 and 358* In two cases involving sales from Oklahoma and Wyoming, respectively,²⁸⁵ the Commission retreated temporarily from its position that the "line" is to be determined as of the date of the contracts in issue and that the Policy Statement is not applicable to contracts which antedate it. In both of these cases the contracts in issue were executed *prior* to the Policy Statement, and in both cases the initial rates and areas prescribed by the Policy Statement were applied mechanically by the Commission. The Oklahoma sales were made from a producing area which straddled the boundary of two of the Commission's Policy Statement pricing areas. Accordingly, the price allowed the various producers depended upon the part of the producing area from which their gas was produced.

In each of these cases the Commission referred to the initial area price prescribed in the Policy Statement as a "ceiling." In the Wyoming case, the Commission went further: "This ceiling represents *an administrative judgment of the initial price line* which the courts have admonished this Commission to hold in certificate pro-

²⁸³ *Id.* at 678. *Atlantic Ref. Co. v. Public Serv. Comm'n*, 360 U.S. 378 (1959), discussed in text accompanying notes 34 and 99-139 *supra*.

²⁸⁴ 316 F.2d at 679.

²⁸⁵ *Michigan Wisconsin Pipe Line Co.*, 27 F.P.C. 449 (1962); *El Paso Natural Gas Co.*, 27 F.P.C. 1134 (1962).

ceedings under Section 7. . . .²⁸⁶ In each case the appropriateness of enforcing the area "ceiling" was found to be confirmed by previously certificated sales in the area.²⁸⁷

With respect to the Oklahoma sales, the Commission approved an arrangement whereby producers were prepaid for a sizeable quantity of gas. Agreement by the producers to defer deliveries in the early years of the contract to meet a peculiar supply requirement of the purchaser was said by the Commission to be a "service or forbearance" by the producers justifying the small additional cost of the prepayment. Further, with respect to these sales, an *upward* price adjustment for gas having a heating value in excess of a prescribed figure was permitted pending the conclusion of proceedings concerning "pipeline quality gas,"²⁸⁸ but the producers were required to file rate schedules providing for a similar *downward* adjustment.

(6) *Opinion 359* In one case²⁸⁹ the Commission was confronted with proposed sales from northeastern Utah, for which no initial rate had been prescribed in the Policy Statement. The Commission required that the proposed initial rates be reduced to the level prescribed by the Policy Statement for adjoining Wyoming. Again the contracts had been executed prior to the Policy Statement. Previously certificated sales at higher prices from the Aneth field²⁹⁰ in southeastern Utah were not given weight in establishing the "line" applicable to the sales in question because they were made from "wholly unrelated" marketing and geological producing areas. Other Utah sales were treated similarly because they did not involve "sufficient quantities of gas, or enough contracts, to constitute an established and stable market for gas."²⁹¹

The producers argued that an additional allowance should be permitted for gathering, dehydration, and compression services performed by them beyond the wellhead. The producers relied on a previous case involving sales from Oklahoma²⁹² in which an allowance was permitted. The argument was rejected and the Oklahoma case was distinguished because the gas in the instant case was casinghead

²⁸⁶ 27 F.P.C. at 1136. (Emphasis added.)

²⁸⁷ The Commission did *not* limit its consideration to sales under contracts executed contemporaneously with those in issue.

²⁸⁸ See note 255 *supra*.

²⁸⁹ Standard Oil Co., 27 F.P.C. 1153 (1962), *on rehearing*, 28 F.P.C. 292 (1962), *aff'd sub nom.* California Oil Co. v. FPC, 315 F.2d 652 (10th Cir. 1963).

²⁹⁰ El Paso Natural Gas Co., 23 F.P.C. 369, 11 O. & G.R. 889 (1960), *aff'd sub nom.* Texaco, Inc. v. FPC, 290 F.2d 149 (5th Cir. 1961), discussed in text accompanying notes 173-176 *supra*.

²⁹¹ 27 F.P.C. at 1157.

²⁹² Panhandle Eastern Pipe Line Co., 27 F.P.C. 35, 15 O. & G.R. 877 (1962), discussed in text accompanying notes 263-270 *supra*; see especially text in paragraph preceding note 268 *supra*.

gas which required processing to be of pipeline quality and because gathering, dehydration, and compression were necessary incidents of such processing for which the producers were entitled to no additional allowance. By contrast, gas-well gas which was of pipeline quality at the wellhead was involved both in the Oklahoma sales (for which an increment was allowed for processing which ordinarily would have been performed by the pipeline) and in the sales from which the Policy Statement price for Wyoming was derived. The Commission conceded that the producers might be entitled to an additional price allowance based on the cost of the services in question allocable to the shut-in was-well gas involved in the sale. However, such an allowance was denied because of the absence of record evidence which the Commission regarded as necessary to determine the appropriateness or the amount of such an allowance. It was said that in any event such an additional allowance would not be proper unless it was shown that the gas-well gas was of pipeline quality at the wellhead and that the additional services performed by the producers would save the pipeline purchaser the cost of performing the same services.

In its order on rehearing,²⁹³ the Commission held that evidence of higher drilling costs and greater difficulty of exploration and development in Utah than in Wyoming did not justify an incentive bonus for the sales in question. It noted that no radical difference existed between the two areas with respect to these factors and that there was no evidence that the price allowed would not provide a sufficient incentive to supply the pipeline's needs.

The Commission's action in this case was upheld on appeal.²⁹⁴ Reliance on Wyoming sales and refusal to allow an increment over the Wyoming price as an incentive to development were held to be supported by evidence that the Wyoming sales used as the basis of the price condition were made from a region similar to the area of the sales in question with respect to geology, geography, and the conditions of exploration, production, and marketing. Refusal to allow a bonus for services performed beyond the wellhead was held to be justified by evidence that the gas in question was casinghead gas and not of pipeline quality until processed. The latter point, however, was not analyzed very carefully by the court. The fact that both casinghead gas and gas-well gas were involved was ignored. Further, the court observed that it was appropriate for the Commission to treat the producers in this case differently from those in

²⁹³ 28 F.P.C. 292 (1962).

²⁹⁴ *California Oil Co. v. FPC*, 315 F.2d 652 (10th Cir. 1963).

the Oklahoma case (in which a service bonus was allowed) because the *spirit* of the Policy Statement would be violated by applying principles for the sale of gas in Oklahoma to the sale of gas in Utah. Presumably, in so observing, the court was merely stating that different facts necessarily yield different results and was not sanctioning application of the Policy Statement in other than an even-handed manner.

The court expressed "serious doubts" that the evidence presented by the producers concerning the high cost of exploration and drilling operations in this area and the cost of services performed by producers beyond the wellhead was "relevant at all in determining the 'in line' price."²⁹⁵ In this connection it said: "We do not think that the Commission was required in this case to consider the exploration and drilling costs or the cost of delivery services in arriving at the 'in line' price in a certification proceeding. The consideration of these matters may properly be left to a section 4 proceeding."²⁹⁶

The court concluded by observing that after complying with the initial rate condition, the producer was free to file a rate increase up to the initial price set by its contract or could "properly present its case for a higher sale price in the pending area price hearing in Docket No. R-218."²⁹⁷

(7) *Skelly* The foundation of the Commission's current policy with respect to the rate issue in producer certificate cases was laid in the *Skelly* case²⁹⁸ involving sales from Texas Railroad District No. 4. Because the contracts had been executed *prior* to the Policy Statement, the Commission held that the Policy Statement was not applicable to these sales. Indeed, the certificates were conditioned to a price 3 cents *below* that prescribed for the area in the Policy Statement. It was stated that in no event could the Policy Statement effect "automatic approval of proposed rates."²⁹⁹ As it had done in the

²⁹⁵ *Id.* at 659. The Policy Statement was said by the court to reflect "in line" prices. *Id.* at 655.

²⁹⁶ *Id.* at 660.

²⁹⁷ *Ibid.* This statement by the court is confusing because (1) the proceedings in Docket No. R-218 are not area price hearings but are concerned only with proposed revisions of area boundaries (see note 266 *supra*) and (2) no area price hearings were (or are) pending concerning Wyoming or Utah.

²⁹⁸ *Skelly Oil Co.*, 28 F.P.C. 401, 16 O. & G.R. 865 (1962), *modified*, 28 F.P.C. 1065 (1962), *rev'd on other grounds sub nom.* Public Serv. Comm'n v. FPC, 329 F.2d 242 (D.C. Cir. 1964), *cert. denied*, 377 U.S. 963 (1964).

²⁹⁹ 28 F.P.C. at 407, 16 O. & G.R. at 871. The Commission specifically limited the application of this proposition to the "area ceilings" set forth in the Policy Statement and stated that the effect to be given area prices developed upon a record in an area proceeding was a different question. Deliveries of gas in this case had been initiated *after* the Policy date of contracting, rather than the date of initial deliveries, as significant in testing initial rates. 28 F.P.C. at 1066.

remanded CATCO case,³⁰⁰ the Commission measured the prices in question not against the Policy Statement price for the area, but against the price "line" as of the time the contracts were executed. Based upon an exhibit in tabular form showing sales permanently and temporarily certificated under contracts made in 1958, 1959, and 1960, the Commission concluded that the price "line" prior to the date of the Policy Statement was 15 cents. This price was determined by eliminating from consideration higher prices which were (1) subject to litigation (*i.e.*, "suspect"); (2) "like suspect" prices;³⁰¹ (3) received by a gathering company;³⁰² or (4) charged under sales to a new, uncertificated pipeline not yet in operation.³⁰³

The Commission gave little weight to prices under temporary certificates because such certificates "are issued informally, *ex parte* and necessarily without time for full investigation."³⁰⁴ It did not enunciate a formula by which the "line" was to be determined based on volumes sold or number of contracts executed; instead the Commission stated that *in its judgment* 15 cents represented a reasonable limit on prices arrived at in contracts dated during 1958, 1959, and 1960, and not subject to litigation.

A most significant aspect of this case was the ruling on evidentiary matters. The Commission refused to give *any* weight to economic and financial evidence presented to show the replacement cost of gas and held that "cost of service and financial requirements evidence normally is not relevant in producer certificate cases. . . ."³⁰⁵ The Commission said that it was not foreclosing justification of a price above the Policy Statement level by evidence of compelling circumstances; however, it held that a "convincing showing" that evidence of such "compelling circumstances" was essential to a just disposition of the rate issue would be required in the future in order for the type of evidence to be admissible that "would customarily be presented in establishing a just and reasonable rate."³⁰⁶

³⁰⁰ Continental Oil Co., 27 F.P.C. 96, 15 O. & G.R. 841 (1962), *clarified and rehearing denied*, 27 F.P.C. 592 (1962), discussed in text accompanying notes 271-278 *supra*.

³⁰¹ Included within the "like suspect" prices were prices "like" the prices under review in the case before it. The Commission stated that it had not been shown that such prices were not subject to "the same infirmities as those which are under test in the *Skelly* proceeding [the case under discussion] pending before us." 28 F.P.C. at 409, 16 O. & G.R. at 874. (Emphasis added.)

³⁰² A large permanently certificated sale by a gathering company at 17 cents was held "not comparable" to those under review because that company purchased all the gas it sold. 28 F.P.C. at 408 n. 14, 16 O. & G.R. at 873 n. 14.

³⁰³ The Commission reasoned that such sales "may have resulted in higher prices than would have resulted from contracts with an established pipeline." 28 F.P.C. at 410 n. 20, 16 O. & G.R. at 874-75 n. 20.

³⁰⁴ 28 F.P.C. at 409, 16 O. & G.R. at 874.

³⁰⁵ 28 F.P.C. at 411, 16 O. & G.R. at 876.

³⁰⁶ 28 F.P.C. at 411, 16 O. & G.R. 876-77.

Four of the contracts consolidated with this proceeding had been executed *after* the date of the Policy Statement. These applications were severed from the proceeding and were reconsolidated with other pending applications involving post-Policy Statement contracts.³⁰⁷ The Commission took this action because the record before it did not deal with "the effect, if any, which should be given to the prior establishment of the 18-cent area ceiling upon the determination of the appropriate price at which we should issue permanent certificates for these contracts."³⁰⁸ Because this question had not been before it previously, the Commission stated that it was not prepared in advance of hearings to say that its own "ceiling prices" were entitled to no weight in determining initial prices under contracts executed after such "ceiling prices" were in effect. The Commission made it clear, however, that it was not suggesting that the announcement of its "ceiling prices" had the effect of raising the "in-line" price to that level.

On the same day it issued the *Skelly* opinion, the Commission promulgated the Fifth Amendment to its Policy Statement,³⁰⁹ reducing the "appropriate level of initial ceilings" in Texas Railroad District No. 4 from 18 cents to 16 cents effective as of the date of the amendment. The Commission stated that its "guiding purpose" in taking this action was to arrive at a revised price which would enable it "to hold the line on new sales in this area at a level consistent with the public interest and, at the same time, to enable producers to obtain authorizations which provide them a reasonable basis for proceeding with their operations and furnishing needed supplies of gas."³¹⁰ Dissenting, Commissioners Ross and Morgan argued that the revised area level should be the 15-cent price "line" applied in *Skelly*. They equated Policy Statement prices with "in line" prices and found nothing to indicate that the "line" had moved upward since the contracts involved in *Skelly* had been executed.

The Commission's decision on the rate issue in the *Skelly* case was affirmed by the Court of Appeals for the District of Columbia.³¹¹ The court held that the evidence before the Commission adequately supported the condition imposed. The limitations placed by the Commission upon the evidence to be considered in resolving the initial

³⁰⁷ This case has been decided. *Amerada Petroleum Corp.*, No. 422, FPC, March 23, 1964, *rehearing denied*, No. 422A, FPC, May 27, 1964, discussed in text accompanying notes 348-355 *infra*.

³⁰⁸ 28 F.P.C. at 412, 16 O. & G.R. at 878.

³⁰⁹ 28 F.P.C. 441, 16 O. & G.R. 962 (1962). See note 258 *supra* for the other amendments to the Policy Statement.

³¹⁰ 28 F.P.C. at 442, 16 O. & G.R. at 962.

³¹¹ *Public Serv. Comm'n v. FPC*, 329 F.2d 242 (D.C. Cir. 1964), *cert. denied*, 377 U.S. 963 (1964).

rate question were upheld. Consideration by the Commission of evidence concerning cost and financial requirements was ruled unessential. The court carefully pointed out, however, that it was not holding that the Commission could never consider such evidence in a certificate case. The court also approved the determination of the "line" as of the date of contract execution rather than the date of initial deliveries.

(8) *Opinion* 383 The Commission's certificate decisions since *Skelly* have been, for the most part, reprises of *Skelly*'s basic theme, although new overtones have been added. The "suspect price" doctrine, for example, has been developed further. Thus, in finding a 16-cent pre-Policy Statement "line" in Texas Railroad District No. 3, the Commission "discounted" not only prices under permanent certificates subsequently set aside, but also those under certificates which "would have been set aside" but for procedural defects in obtaining review of such prices.³¹² The Commission observed, however, that although the "suspect price" doctrine required that prices in litigation or which had been set aside in litigation not be taken at face value as reflecting firm prices in the area, it was not intended as "a rigid exclusionary rule." It stated that if this "doctrine" were so applied:

[C]omparatively low prices at fair and readily defensible levels might be made subject to litigation at the will of some intervening party and our authority to determine proper initial prices under the Natural Gas Act thus limited for reasons that are unrelated to the public interest. Furthermore, we think that merely because prices are in litigation or have been set aside after litigation and further proceedings ordered thereon, we should not entirely overlook the economic tendencies which they represent.³¹³

Nevertheless, the Commission concluded that substantial weight could not be given "suspect" prices until the parties relying upon them showed their actual effect upon the "line," a showing found not to have been made in this case.

In the same case, the Commission specifically stated that the rate condition imposed would not preclude the producer's filing an increase to the full contract price and collecting such price (subject to an obligation to refund) after the expiration of the statutory suspension period. In this connection the Commission said:

³¹² *Texaco Seaboard, Inc.*, 29 F.P.C. 593, 597, 17 O. & G.R. 874, 880 (1963), *rehearing denied*, 30 F.P.C. 613 (1963). On the same day it issued its decision in this case, the Commission issued the Sixth Amendment to the Policy Statement, reducing the initial rate level prescribed for Texas Railroad District No. 3 from 18 cents to 17 cents. 28 F.P.C. 590, 17 O. & G.R. 894 (1963).

³¹³ 29 F.P.C. at 598-99, 17 O. & G.R. at 881.

We recognize, of course, that unnecessarily large refund obligations can have detrimental effects upon all elements of the gas industry, and therefore do not intend to cut back the price below that at which significant sales of gas were permanently certificated in the area at the time of the . . . contract. We think it clear, however, that the possibility that the applicable just and reasonable area rate may turn out to be higher than the in-line rate we here establish, is at least balanced in the public interest scales by the ever present risk that the in-line rate in District No. 3 may be too high in relation to the just and reasonable rate for the gas we shall eventually determine.³¹⁴

In denying rehearing in this case,³¹⁵ the Commission discussed the relationship between Policy Statement prices and "in-line" prices. It emphasized that Policy Statement prices are "guidelines" for *future* action and *have no retroactive effect*, and found no inconsistency between its determination of a 16-cent price "line" as of a date in 1960 and its promulgation of a 17-cent price "guideline" for 1963 and future years. The Commission summarized the significance of Policy Statement prices as follows:

*Such guideline prices are at levels at which the Commission will grant permanent certificates in non-contested cases and authorize temporary service in emergencies. By fixing these rates we do not foreclose the possibility that the parties in a contested proceeding may persuade us that the level at which we should certificate a particular new sale should be at either a higher or lower price. Our determination will be based upon the record in each proceeding in accordance with the principles enunciated in CATCO and Skelly and herein.*³¹⁶ (Emphasis added.)

In the same order, the Commission indicated that the date of contract might not always be determinative in evaluating initial prices. If a producer seeking authority under a 1960 sales contract were to cancel the contract and to enter into a new contract in 1963, "the price," the Commission said, "would be subject to consideration in an appropriate proceeding in which *the history of the transaction would be . . . highly relevant.*"³¹⁷ The Commission made it clear that the Policy Statement price applicable in 1963 would not apply automatically to such a contract.

(9) *Opinion 390* In another recent case,³¹⁸ the Commission approved, in addition to a 17-cent initial price,³¹⁹ a contractual arrange-

³¹⁴ 29 F.P.C. at 599, 17 O. & G.R. at 882.

³¹⁵ 30 F.P.C. 613 (1963).

³¹⁶ *Id.* at 616.

³¹⁷ *Id.* at 615. (Emphasis added.)

³¹⁸ El Paso Natural Gas Co., 29 F.P.C. 1175 (1963).

³¹⁹ The initial price prescribed by the contracts was 21 cents. 29 F.P.C. at 1177-78. Because the contracts had been executed prior to the Policy Statement, the price condition was based on other contemporaneous sales rather than on the Policy Statement.

ment under which producers selling gas rich in liquid hydrocarbons from the Oklahoma Panhandle area would receive (in cash or in kind), as compensation for relinquishing their right to extract these liquids, one-fourth of any liquids extracted by the gas purchaser. The Commission disapproved a provision that the producers should receive no less than 1 cent per Mcf for the liquid content of the gas. To permit this minimum guarantee, said the Commission, would be tantamount to a flat allowance of 18 cents per Mcf in an area in which the "in-line" price was no more than 17 cents per Mcf. However, the Commission ordered that for all gas not processed by the purchaser, the producers were to receive additional compensation equal to one hundredth of a cent per Mcf multiplied by the difference between the average Btu content of processed gas and that of unprocessed gas up to a maximum of .95 cents per Mcf. The apparent basis for this order was that (1) the Commission had permitted upward price adjustments for high Btu gas³²⁰ to stand with respect to other sales in the same area, (2) there were no such price adjustments in the contracts in question, and (3) the producers would otherwise receive no compensation for the liquids in gas which the purchaser elected not to process.

Under this limited arrangement, the producers would not be compensated for the Btu content of the processed gas in excess of 1,000, which the Commission conceded was normally attributable to "pipeline quality gas." The Commission's explanation was that nothing appeared in the record to show how the "extra values" remaining in the gas stream beyond the processing plant would be utilized, while in other cases in which compensation had been allowed for Btu content in excess of 1,000 it had been clear that such "extra values" would be utilized to enrich lean gas in the purchaser's system. The Commission stated that the "*sine qua non*" of its acceptance of the Btu adjustment in those cases was a showing that such adjustment would not adversely affect the customers of the gas purchaser—a showing that had not been made here.

(10) *Opinion 397* The first case to come before the Commission in which the sales contracts had been executed *after* the Policy Statement involved sales from Ohio and Pennsylvania, areas for which no price was prescribed in the Policy Statement.³²¹ As it had done in cases involving contracts executed before the Policy Statement, the Commission relied on evidence of certificated sales being made

³²⁰ In general, gas with a high heating value (which is measured in Btu's per cubic foot) contains more extractable liquid hydrocarbons than gas with a lower heating value.

³²¹ Medina Gathering Corp., 30 F.P.C. 227 (1963).

in the area at the time the contracts were executed and found a 27-cent "line," 3 cents below the initial price provided by the contracts. It thus overruled the examiner who had attached a price condition of 27.45 cents based on the initial price prescribed by the Policy Statement for neighboring West Virginia. In this connection, the Commission noted that the producers had expressly disclaimed any reliance on the Policy Statement price for West Virginia.

The contracts in this case had twenty-year terms and provided for three fixed 1-cent escalations, in contrast with the prevailing area practice of utilizing life-of-lease contracts with no escalation provisions. The Commission concluded that the additional value which this provision represented to the producers was roughly offset by the value to the purchaser of another contract provision permitting the purchaser to take all of the gas during the winter months. This degree of flexibility was found to be unusual in the area and was regarded by the Commission as an "additional feature of the proposed sale which is of objectively measurable value."³²² No added value, however, was attached to the purchaser's option to acquire storage rights in the wells upon cessation of production because this option was not unusual in gas contracts in the area.

(11) *Placid* Perhaps the most startling of the Commission's innovations during the post-Policy Statement period was the attachment of conditions to producer certificates prohibiting for a specified period the filing of rate increases above a prescribed level. The first case in which this device was employed involved a number of south Louisiana certificate applications which were before the Commission for a second time as a result of judicial remand.³²³ Following its precedent in the remanded *CATCO* case,³²⁴ the Commission imposed a rate condition enforcing a "line" of 18.5 cents and permitted a tax reimbursement of 1.5 cents with respect to sales made within the taxing jurisdiction of the State of Louisiana.³²⁵ In so doing, the Commission affirmed the examiner's rejection of economic and fi-

³²² *Id.* at 232.

³²³ *Placid Oil Co.*, 30 F.P.C. 283 (1963), *rehearing denied*, 30 F.P.C. 682 (1963), *rev'd sub nom.* Callery Properties, Inc. v. FPC, 335 F.2d 1004 (5th Cir. 1964).

³²⁴ *Continental Oil Co.*, 27 F.P.C. 96, 15 O. & G.R. 841 (1962), *clarified and rehearing denied*, 27 F.P.C. 592 (1962), discussed in text accompanying notes 271-278 *supra*.

³²⁵ As it had done in *CATCO*, the Commission required the producers to make refunds of amounts collected in excess of 18.5 cents (plus 1.5 cents tax where applicable) since first deliveries under the permanent certificates originally issued in 1959. However, with respect to one sale commenced under a temporary certificate which contained no refund condition, the Commission did not require the producer to refund amounts collected while the temporary certificate was in effect. The allowance for take-or-pay provisions in the producers' contracts was made subject to the outcome of a pending rule-making proceeding, as was done in *Panhandle Eastern Pipe Line Co.*, 27 F.P.C. 33, O. & G.R. 877 (1962). See text accompanying note 270 *supra*.

nancial evidence as being "irrelevant to the determination of the initial price question in independent producer certificate cases."³²⁶

In addition to the condition concerning the initial rate, the Commission imposed the further condition that the producers could file no rate increase to a level in excess of 23.55 cents until the conclusion of the south Louisiana area rate proceeding or until July 1, 1967, whichever is earlier.³²⁷ It stated (1) that increases above 23.55 cents would have a widespread "triggering" effect in south Louisiana, (2) that the public would not be protected completely by the producers' obligation to refund, and (3) that the "line" would not be held pending the determination of just and reasonable rates if the filing of increases to levels above 23.55 cents were permitted.³²⁸ In denying rehearing,³²⁹ the Commission said that "it would not serve the public convenience and necessity" to allow increases to above 23.55 cents during the moratorium period which it had prescribed "*even if such rate were indicated on the basis of individual company cost of service concepts.*"³³⁰

On appeal, the Commission was reversed by the Fifth Circuit.³³¹ The court held that the Commission had erred (1) in rejecting cost and financial evidence offered by the producers, (2) in imposing a moratorium on rate increases, and (3) in requiring refunds of amounts collected in excess of the initial rate determined by the Commission to be required by public convenience and necessity. It was held that the Commission's allowance of take-or-pay clauses subject to future orders in a pending rule-making proceeding was not a reviewable order.

In holding erroneous the exclusion of cost and financial evidence, the court took a vigorous slap at the "new" Commission's basic approach in producer certificate cases. Producers were said to have "positive rights" under section 7(e) of the act,³³² and it was held that the Commission does not fulfill its statutory duty by a limited inquiry into whether a proposed price is "in line." In this connection, the court said:

³²⁶ 30 F.P.C. at 287.

³²⁷ 30 F.P.C. at 298, 300. The south Louisiana area rate proceeding, which was instituted in 1961, was still in its initial stages at the time of this writing.

³²⁸ In another case issued the same day, the Commission imposed the same price increase moratorium on certificates authorizing south Louisiana sales and based its action in part upon a *rate case settlement* by each producer, which "leads us to believe that any rate higher than the conditioned initial price herein determined could not be found just and reasonable." United Gas Pipe Line Co., 30 F.P.C. 329, 334 (1963), *appeal dismissed sub nom.* Gulf Oil Corp. v. FPC, 330 F.2d 824 (5th Cir. 1964).

³²⁹ 30 F.P.C. 682 (1963).

³³⁰ *Id.* at 686. (Emphasis added.)

³³¹ Callery Properties, Inc. v. FPC, 335 F.2d 1004 (5th Cir. 1964).

³³² 56 Stat. 84 (1942), 15 U.S.C. § 717f(e) (1958).

In the concept of public convenience and necessity, price is, of course, very important. But it is not the whole thing. And certainly under a statutory scheme for a utility-type of regulation for the sale, not of a service, but of a depletable commodity, where the Commission serves primarily as a rate-reviewing, not a rate-fixing agency, and in which the entry into the regulated market is the voluntary act of the gas producer, it is perfectly evident that many factors other than price alone bear upon public convenience and necessity and, in turn, upon price.³³³ (Footnotes omitted.)

The question of the nature and extent of demand and the availability of supplies to meet it was regarded by the court as one of the most critical factors bearing upon public convenience and necessity. "[T]he decisive question," said the court, "then becomes what price will it take to get the needed gas?"³³⁴ The view was expressed that "a price-only approach" could harm the public interest by keeping needed gas off of the interstate market simply because the price was "out of line."

The court concluded that the cost and financial evidence which had been offered by the producers "bore upon" the question of public convenience and necessity and should have been received by the Commission. By footnote, however, the court commented that if the Commission had received the evidence in question and had found it to be wanting, "that might well have been the end of the matter."³³⁵

The moratorium on rate increases was held to be contrary to section 4 of the act.³³⁶ The court found support for its position in the distinction drawn by the Supreme Court between temporary and permanent certification procedures in a recent case³³⁷ upholding a condition prohibiting the filing of rate increases during the pendency of a temporary certificate. With respect to rate increases filed after permanent certification, the court held that consumers were afforded full protection by the suspension and refund procedures of section 4(e). Any further triggering of price increases caused by such filings was said to be the result of the act's unique scheme, which could be changed by Congress but not by the Commission or the courts.

The court ruled that the Commission could require refunds, but that "to meet the exigencies of this unique case" they should be based on the difference between the price collected and the price ultimately found in a proper proceeding to be just and reasonable, rather than

³³³ 335 F.2d at 1012-13.

³³⁴ *Id.* at 1013.

³³⁵ *Id.* at 1015 n. 30.

³³⁶ 52 Stat. 822 (1938), as amended, 15 U.S.C. § 717c (1958).

³³⁷ FPC v. Hunt, 376 U.S. 515 (1964), discussed in text accompanying notes 450-454 *infra*.

the price determined on remand to be proper under section 7 standards. The "exigencies" referred to by the court were (1) the fact that gas deliveries under the certificates in question had been made for over five years and (2) the possibility that producers ultimately could receive less than a just and reasonable rate for gas delivered during this period if (a) refunds were required down to the price determined to be consistent with section 7 standards and if (b) the just and reasonable rate determined for these sales were *higher* than the price determined to be required by the public convenience and necessity. In this event, said the court, there would be no means by which the excessive refund could be recouped by the producers because the Commission has no power to require reparations.

(12) *Hunt* Late in the post-Policy Statement period, disenchantment with the "suspect price" doctrine as it had been applied by the Commission in *Skelly*³³⁸ and subsequent cases became apparent among some of the Commissioners. This was manifested in a recent decision³³⁹ in which the Commission found and enforced a "line" of 15 cents in Texas Railroad Districts No. 2 and No. 4, and 16 cents in District No. 3. In arriving at the "line" for District No. 2, the Commission gave no weight to one sale involving monthly volumes of 345,000 Mcf that had been permanently certificated at 17 cents.³⁴⁰ The reason given for disregarding this sale was that it was made by a gathering company, "and thus is not comparable to sales by producers."³⁴¹ A permanently certificated producer sale at 17 cents involving 93,000 Mcf per month was accorded diminished weight because other sales in the area at 15.5 cents and 17 cents were again before the Commission for review on judicial remand.³⁴² Further, the Commission ignored sales totaling nearly 225,000 Mcf per month under temporary certificates at prices of 17 cents and above. Thus, the "line" imposed by the Com-

³³⁸ *Skelly Oil Co.*, 28 F.P.C. 401, 16 O. & G.R. 865 (1962), *modified*, 28 F.P.C. 1065 (1962), *rev'd on other grounds sub nom.* Public Serv. Comm'n v. FPC, 329 F.2d 242 (D.C. Cir. 1964), *cert. denied*, 377 U.S. 963 (1964), discussed in text accompanying notes 298-311 *supra*.

³³⁹ *Hassie Hunt Trust*, 30 F.P.C. 1438 (1963), *rehearing denied*, 31 F.P.C. 181 (1964). Half of the applications in this case were before the Commission a second time on judicial remand. See discussion of prior proceeding in text accompanying notes 186-192 *supra*. On the same day this decision was issued, the Commission promulgated the Eight Amendment to the Policy Statement, reducing the initial rate level applicable to Texas Railroad District No. 2 from 18 cents to 16 cents. 28 Fed. Reg. 13547 (1963), 19 O. & G.R. 478 (1963).

³⁴⁰ The Commission also disregarded another sale of unspecified volume certificated permanently at 17 cents because the contract was executed *before* 1958, the earliest year that any of the contracts in question were executed, and was "therefore outside the scope of our tabulation." 30 F.P.C. at 1444 n.e.

³⁴¹ 30 F.P.C. at 1444 n.e.

³⁴² These cases had been remanded not on the merits, but because the Commission had denied intervention to the New York Public Service Commission. Public Serv. Comm'n v. FPC, 295 F.2d 140 (D.C. Cir. 1961), *cert. denied*, 368 U.S. 948 (1961).

mission was 2 cents below the price at which some 663,000 Mcf of gas was being sold monthly with Commission approval under contracts executed contemporaneously with those in issue.

Commissioners O'Connor and Woodward objected to the majority's failure to give weight to four of these sales involving nearly 483,000 Mcf per month. To them the fact that two of these sales were being made under temporary authority was of no moment because unconditioned permanent certificates covering these sales would have been issued "had they been requested at the time."³⁴³ Prices received by gathering companies were said to have probative value in determining the "line" because area prices for Texas Railroad District No. 2 had been interpreted by the Commission to include the cost of gathering the gas and getting it to the transmission company, making the "price of gathered gas for District No. 2 . . . a legitimate consideration regardless of whether this gathering is done by the producer or a separate entity."³⁴⁴ The majority's application of the "tainted" price doctrine was condemned in the following words:

This doctrine, originally very narrow in scope, has been expanded beyond all justifiable limits. It has come to stand for the proposition that all contracts with rates higher than the ceiling which the majority seeks to establish can be discarded as "tainted." The obvious result of such an interpretation, as evidenced by this present proceeding, is to produce any desired result regardless of irrefutable facts.³⁴⁵

In the same case, the Commission, consistent with its action in *Skelly*,³⁴⁶ severed applications involving contracts executed after the Policy Statement to be heard with other applications involving contemporaneous contracts. It held that the record in the case before it failed to reflect post-Policy Statement changes, including the effect, if any, of the Policy Statement upon the "in line" price in the area.³⁴⁷ The Commission rejected the examiner's position that an absence of producer evidence showing changed circumstances resulting from the promulgation of the Policy Statement was sufficient to support the treatment of post-Policy Statement sales in the same manner as pre-Policy Statement sales.

(13) *Amerada* In one of the last major certificate decisions at the

³⁴³ 30 F.P.C. at 1449, 50.

³⁴⁴ *Ibid.*

³⁴⁵ *Ibid.*

³⁴⁶ *Skelly Oil Co.*, 28 F.P.C. 401, 16 O. & G.R. 865 (1962), *modified*, 28 F.P.C. 1065 (1962), *rev'd on other grounds sub nom. Public Serv. Comm'n v. FPC*, 329 F.2d 242 (D.C. Cir. 1964), *cert. denied*, 377 U.S. 963 (1964), discussed in text accompanying notes 298-311 *supra*.

³⁴⁷ 30 F.P.C. at 1442.

time of this writing,³⁴⁸ the Commission actually retreated somewhat from the "suspect price" doctrine as it had applied it previously. This decision concerned contracts covering gas in Texas Railroad District No. 4. They were executed *after* the Policy Statement, which prescribed an initial price of 18 cents for the area, but *before* the Fifth Amendment thereto,³⁴⁹ which reduced the prescribed initial price to 16 cents. By a process of reasoning that was a startling departure from that adopted in previous cases, the Commission refused to apply perfunctorily the 15-cent "line" which it had found in *Skelly*³⁵⁰ for pre-Policy Statement contracts in this area, and instead determined that the "line" during the period in question was 16 cents.

The Commission confined its inquiry to contracts executed during the period in issue. Because permanently certificated sales under contracts entered into during this period accounted for only a very small proportion of the total volumes of gas moving in interstate commerce under all contracts executed during the period, the Commission determined the "in-line" price on the basis of the contract prices at which substantial volumes were sold during this period *under temporary or permanent certificates*. It thus overruled the examiner's holding that temporary certificates and permanent certificates issued in uncontested proceedings were entitled to little or no weight. The fact that a permanent certificate was issued in a noncontested proceeding was held not to affect its value as a precedent. It was stated that although prices under permanent certificates "are decidedly more persuasive and relevant,"³⁵¹ prices under temporary certificates were neither per se "suspect" nor inadmissible to establish an "in-line" price. The Commission concluded that to exclude temporary certificates from consideration in this case would preclude meeting the requirement that the "line" be based on substantial volumes of gas moving in interstate commerce. Under this approach, therefore, the "in-line" price applied to each of the sales in issue was based primarily upon the prices at which the other sales in issue were being made.

The Commission also addressed itself in this case to the question that it had raised in *Skelly*; viz., what weight is to be given in a certificate case to the initial rate set forth in the Policy Statement as

³⁴⁸ *Amerada Petroleum Corp.*, No. 422, FPC, March 23, 1964, *rehearing denied*, No. 422A, FPC, May 27, 1964.

³⁴⁹ 28 F.P.C. 441, 16 O. & G.R. 962 (1962).

³⁵⁰ *Skelly Oil Co.*, 28 F.P.C. 401, 16 O. & G.R. 865 (1962), *modified*, 28 F.P.C. 1065 (1962), *rev'd on other grounds sub nom.* Public Serv. Comm'n v. FPC, 329 F.2d 242 (D.C. Cir. 1964), *cert. denied*, 377 U.S. 963 (1964), discussed in text accompanying notes 298-311 *supra*.

³⁵¹ No. 422, FPC, March 23, 1964.

of the time the contracts in question were executed? Here the Policy Statement rate had been 18 cents at the time the contracts were executed. It was observed by the Commission that the existence of this "guide" had exerted considerable influence in the negotiation of the contracts in question. The Commission concluded that such price should be given "some measure of weight" but refused to ascribe to it "an irrebutable conclusiveness." In this connection, the Commission pointed out that from the outset it had been obvious that the prices set forth in the Policy Statement were guides only and would not affect substantive rights.

It is impossible to determine from the Commission's opinion exactly what weight actually was given to the Policy Statement rate in effect when the contracts were executed, but it would appear to be very slight. Primary reliance was placed on the finding that 16 cents was the "in line" price. Having reviewed both the field price evidence and the import of the 18-cent Policy Statement standard, the Commission concluded:

In the final analysis our action in fixing the price at which these sales should be certificated requires *an exercise of our informed judgment and utilization of the expertise* developed in the handling of thousands of producer certificate applications. *Catco* requires that we hold the line pending the determination of just and reasonable rates. This line cannot, however, always be ascertained with mathematical certainty.³⁵² (Emphasis added.)

Consistent with its action in some other certificate cases, the Commission in this case imposed a moratorium "on the filing of all price increases in excess of 18 cents per Mcf, inclusive of tax reimbursement, pending the issuance of a final decision in the area rate proceeding in Docket No. AR 64-2 or until January 1, 1968, whichever is earlier."³⁵³

In its order on rehearing,³⁵⁴ the Commission addressed itself at some length to one producer's contention that it should be permitted an additional allowance because of transportation charges which it incurred in delivering the gas to the purchaser's main line. The Commission observed that the incurrence of the transportation costs in question was necessary in order to sell the gas because of the relatively disadvantageous location of the producer's reserves. Because the gas delivered by this producer was of no greater value than the gas delivered by the other producers, the Commission concluded that public convenience and necessity did not require that more be paid

³⁵² *Ibid.*

³⁵³ *Ibid.*

³⁵⁴ No. 422A, FPC, May 27, 1964.

for it.³⁵⁵ In the same order, the Commission also rejected an argument that a producer's initial contract price was justified because of its *de minimis* effect on ultimate consumers.

2. Summary of Existing Law

At the time of this writing, ten years after *Phillips*,³⁵⁶ the Commission's approach to the initial rate issue in producer certificate cases has become relatively stable. The journey to this position has been lengthy, tortuous, and beset with concealed pitfalls. The Commission has labored up many blind alleys only to be forced to retreat under judicial fire. Although it is by no means certain that the Commission has reached its ultimate position on the initial rate issue, in view of the favorable reception that the current approach has received in the appellate courts in recent cases,³⁵⁷ it seems unlikely that there will be further changes of a fundamental nature. At this juncture, it is appropriate to summarize the Commission's current position on the initial rate question. Subsequently, the law that "is" will be analyzed in the light of the law that, in the opinion of the writer, "ought to be."

In general, the Commission's current approach to the initial rate issue in certificate cases may be described as one of freezing initial rates through the use of its conditioning power. In each case, this price freeze is imposed at a level no higher than that at which other gas is sold from the same area under contracts executed at about the same time as those involved in the case. The areas within which separate price levels are determined and maintained by the Commission are those set forth in the Policy Statement as "convenient and well known." At present these areas are defined arbitrarily, being delineated for the most part by political boundary lines rather than by geographical, geological, or economic considerations. A proceeding initiated by the Commission to determine whether these areas should be redefined and new areas established³⁵⁸ has been held in abeyance pending further developments in the area rate proceedings.³⁵⁹

In determining the price to be maintained (*i.e.*, the "line") in each area, the Commission places primary reliance on initial prices collected for gas sold under permanent Commission certificates; less weight is

³⁵⁵ The Commission reached a similar conclusion in another recent case. *Superior Oil Co.*, No. 437, FPC, July 23, 1964.

³⁵⁶ *Phillips Petroleum Co. v. Wisconsin*, 347 U.S. 672 (1954). See text accompanying note 23 *supra*.

³⁵⁷ But see *Callery Properties, Inc. v. FPC*, 335 F.2d 1004 (5th Cir. 1964), discussed in text accompanying notes 331-337 *supra*.

³⁵⁸ 27 Fed. Reg. 5714 (1962).

³⁵⁹ 28 Fed. Reg. 12945 (1963).

given prices collected pursuant to temporary certificates. No weight is given to (1) prices collected under permanent certificates with respect to which judicial or administrative appeals or further administrative reviews are pending (*i.e.*, "suspect" prices), (2) prices collected under permanent certificates at the same level as those subject to judicial or administrative review and not shown to be free of the same "infirmities" (*i.e.*, "like suspect" prices), (3) prices collected under permanent certificates for gas sold by gathering companies, (4) prices collected under permanent certificates for gas sold to new uncertificated pipelines, (5) prices collected under permanent certificates for gas sold under contracts executed substantially before or after those in question, and (6) prices not subject to the Commission's jurisdiction. Having thus restricted the scope of its inquiry, the Commission applies its "informed judgment" and "expertise" to the prices to which it gives weight and arrives at a "line."

Occasionally a price increment above the "line" as thus determined is permitted with respect to a particular sale characterized by features of "objectively measurable" value to the purchaser that are not possessed by the sales relied upon by the Commission to establish the "line." As yet the Commission has not defined the features in each area for which additional compensation will be allowed or the value that will be attributed to such features. These matters are pending before the Commission in a rule-making proceeding.³⁶⁰

Considerations such as individual company or industry-wide cost of service, relative drilling costs, cost trends, economics, geology, revenue requirements, and revenue trends are given no weight either in establishing the "line" or in supporting a price above the "line." Indeed, it is the Commission's policy to *reject* evidence concerning such matters as being irrelevant in certificate cases.

The significance of the initial rates set forth in the Policy Statement is still subject to some doubt. It seems clear that the Policy Statement will not be applied to sales under contracts executed before the Policy Statement. With respect to sales under contracts executed after the Policy Statement, its import is not clear. The initial rates prescribed by the Policy Statement have been variously characterized by the "new" Commission as "an administrative judgment of the initial price line," price "ceilings," and "guides" to future administrative action. In recent cases, the Commission has indicated that the rates prescribed by the Policy Statement at the time a sales contract

³⁶⁰ 26 Fed. Reg. 4614 (1961). A related proceeding has been instituted concerning the "ultimate propriety" of Btu price adjustments. *Sunray DX Oil Co.*, 29 F.P.C. 1079 (1963). The Commission has allowed such adjustments to be operative subject to the outcome of the rule-making proceeding.

is executed are to be given "some weight" but cannot be given controlling effect. Nevertheless, it appears that temporary certificates will be issued in almost all cases in which proposed initial rates are no higher than the applicable Policy Statement rates; and if no protest or petition to intervene is filed, permanent certificates will be issued in shortened, noncontested proceedings with no rate-reducing conditions attached.³⁶¹

In almost all of the certificate cases in which rate conditions have been imposed, the Commission has required only that the rate initially charged be reduced to a specified level and has not restricted immediate filing of increases up to the level authorized by contract. Indeed, in some cases the right to make such filings has been specifically recognized. In some very recent cases, however, the Commission has imposed as a condition to certification a moratorium on price increases above a specified "triggering" level, for the stated purpose of forestalling a widespread upward movement of area price levels above those currently being collected.³⁶²

3. Analysis of Existing Law

Having reviewed the gist of the law that "is" (or purports to be) with respect to the initial rate issue in producer certificate cases, this law will be analyzed and measured against the law which, in this writer's opinion, "ought to be." The starting place for such an inquiry is the Natural Gas Act, from which the Commission derives its power to regulate producer rates.

a. Reduction of Producer Rates in Certificate Proceedings

The basic standard prescribed by the act with respect to rates is found in section 4(a) which provides that "*all rates . . . received by any natural gas company for . . . the . . . sale of natural gas subject to the jurisdiction of the Commission . . . shall be just and reasonable, and any such rate . . . that is not just and reasonable is hereby declared to be unlawful.*"³⁶³ Undue preferences and advantages and unreasonable differences in rates are proscribed by section 4(b).³⁶⁴ Section 4(c)³⁶⁵ requires every natural gas company to file schedules with the Commission showing all rates for jurisdictional gas sales.³⁶⁶

³⁶¹ See, e.g., *Davidor & Davidor, Inc.*, No. G-7768, F.P.C., May 18, 1964.

³⁶² One court has recently held that the Commission is without authority to impose such a condition. *Callery Properties, Inc. v. FPC*, 335 F.2d 1004 (5th Cir. 1964), discussed in text accompanying notes 331-337 *supra*.

³⁶³ 52 Stat. 822 (1938), as amended, 15 U.S.C. § 717c(a) (1958). (Emphasis added.)

³⁶⁴ 52 Stat. 822 (1938), as amended, 15 U.S.C. § 717c(b) (1958).

³⁶⁵ 52 Stat. 822 (1938), as amended, 15 U.S.C. § 717c(c) (1958).

³⁶⁶ With respect to independent producers, the Commission by regulation has defined "rate schedule" as "the basic contract and all supplements or agreements amendatory thereof . . . showing the rates . . . applicable to the . . . sale of natural gas in interstate commerce for resale." 18 C.F.R. § 154.93 (1961).

Sections 4(d)³⁶⁷ and 4(e)³⁶⁸ deal with rate changes initiated by natural gas companies. These sections provide that a natural gas company may not change any of its filed rates except after giving thirty days' notice by filing new schedules showing the changes to be made. Upon the filing of the new schedules, the Commission is authorized to initiate a hearing concerning the lawfulness of the new rate and, pending such hearing, to suspend the use of the new rate for a period not longer than five months after it otherwise would go into effect. Thereafter, if the hearing is not completed, the new rate may be put into effect subject to the authority of the Commission to require refunds of any portion found to be unjustified. The only specific provision authorizing the Commission to modify rates filed by natural gas companies, other than upon the initiation of rate changes by such companies, is found in section 5(a).³⁶⁹ Under this section the Commission may initiate a hearing concerning any rate charged by a natural gas company. If, after the hearing, the Commission finds the rate in question to be "unjust, unreasonable, unduly discriminatory, or preferential," section 5(a) provides that the Commission "shall determine the just and reasonable rate . . . to be thereafter observed and in force, and shall fix the same by order."

In a case³⁷⁰ antedating *CATCO*³⁷¹ by just three years, the Supreme Court held that the Commission's authority under the act with respect to rates was limited to reviewing, pursuant to sections 4(d), 4(e), and 5(a), the rates initially established by the regulated natural gas companies, and that the Commission could reduce those initial rates only after a hearing and a finding, pursuant to section 5(a) of the act, that such rates were "unjust, unreasonable, unduly discriminatory, or preferential."³⁷² Speaking of sections 4(d), 4(e), and 5(a) of the act, the Supreme Court said: "These sections are simply parts of a single statutory scheme under which all rates are established initially by the natural gas companies, by contract or otherwise, and all rates are subject to being modified by the Commission upon a finding that they are unlawful."³⁷³

³⁶⁷ 52 Stat. 822 (1938), as amended, 15 U.S.C. § 717c(d) (1958).

³⁶⁸ 52 Stat. 822 (1938), as amended, 15 U.S.C. § 717c(e) (Supp. IV, 1962).

³⁶⁹ 52 Stat. 823 (1938), 15 U.S.C. § 717d(a) (1958).

³⁷⁰ *United Gas Pipe Line Co. v. Mobile Gas Serv. Corp.*, 350 U.S. 332 (1956).

³⁷¹ *Atlantic Ref. Co. v. Public Serv. Comm'n*, 360 U.S. 378 (1959), discussed in text accompanying notes 34 and 99-139 *supra*.

³⁷² In another case, decided the same day, the Court held that the Commission could require an *increase* in a rate established by contract only upon a finding that such rate was so low as to affect the public interest adversely by impairing the financial ability of the regulated company involved, or that such rate was unduly discriminatory. *FPC v. Sierra Pac. Power Co.*, 350 U.S. 348 (1956).

³⁷³ *United Gas Pipe Line Co. v. Mobile Gas Serv. Corp.*, 350 U.S. 332, 341 (1956).

In the same case, the Supreme Court also said that the "basic power" of the Commission under the act was that given it by section 5(a) to set aside and modify any rate or contract which it determined, after hearing, to be "unjust, unreasonable, unduly discriminatory, or preferential." The Court observed that this was neither a rate-making nor a rate-changing procedure, but simply a procedure for the exercise of the Commission's basic function of reviewing rates made in the first instance by natural gas companies. In this connection, the Court had said that "the initial rate-making and rate-changing powers of natural gas companies remain undefined and unaffected by the act."³⁷⁴

The view expressed in this case concerning the Commission's authority with respect to rates accurately reflects the structure of the act. Nothing in the act suggests that the Commission may tamper with initial rates in certificate cases. Section 7 of the act,³⁷⁵ which requires Commission certification of new gas sales, is entirely silent concerning rates. The fundamental prerequisite specified by section 7 for the issuance of Commission authority to initiate a new sale is a finding that the proposed sale "is or will be required by public convenience and necessity";³⁷⁶ and the Commission's conditioning authority is founded on the same standard, *i.e.*, the Commission may impose "such reasonable terms and conditions as the public convenience and necessity may require."³⁷⁷

The phrase "public convenience and necessity," although broad and variously defined in different factual contexts, does not suggest an inquiry concerning the proper rate for a proposed sale or service, but connotes such issues as public need or demand for a proposed sale or service and the ability of an applicant to fulfill adequately that need or demand.³⁷⁸ The absence of any reference to rates in section 7, coupled with the specific provisions in sections 4 and 5 for Commission review of rates and modification of rates found to be unlawful, strongly indicates that Congress did not intend that initial rate levels be modified by the Commission in certificate cases.³⁷⁹

³⁷⁴ *Id.* at 343.

³⁷⁵ 52 Stat. 824 (1938), as amended, 15 U.S.C. § 717f (1958).

³⁷⁶ 56 Stat. 84 (1942), 15 U.S.C. § 717f(e) (1958).

³⁷⁷ *Ibid.*

³⁷⁸ See Johnson, *Producer Rate Regulation in Natural Gas Certification Proceedings: CATCO in Context*, 62 Colum. L. Rev. 773, 777 (1962).

³⁷⁹ See *Callery Properties, Inc. v. FPC*, 335 F.2d 1004 (5th Cir. 1964). Another commentator on the initial rate issue has observed that the "complete divorce of the certification and rate-regulation sections suggests that rates are to be given little consideration in certification," and that "a most cursory reading of sections 4, 5, and 7 leaves one with the uneasy feeling" that the conversion of certificate proceedings into rate hearings and the imposition of specific rate conditions upon certificates "is not at all what Congress had in

Prior to 1942, the Commission's certificate authority was prescribed by section 7(c) of the act³⁸⁰ and was *limited* to situations in which a natural gas company proposed (1) to construct, extend, acquire, or operate facilities for the transportation of natural gas to a market *in which natural gas was being provided already by another natural gas company*; (2) to engage in transportation by means of such facilities; or (3) to sell gas in such market. The following provision of section 7(c) specifically made rates an issue in certificate cases:

In passing on applications for certificates of convenience and necessity, the Commission shall give due consideration to the applicant's ability to render and maintain adequate service at rates lower than those prevailing in the territory to be served, it being the intention of Congress that natural gas shall be sold in interstate commerce for resale for ultimate public consumption for domestic, commercial, industrial, or any other use at the lowest possible reasonable rate consistent with the maintenance of adequate service in the public interest.³⁸¹

In 1942, section 7 of the act was amended;³⁸² the Commission's certificate jurisdiction was broadened, authority to condition certificates was added, and the provision concerning rates was *deleted*. Although the deletion of this provision in the 1942 amendments normally would be strong evidence of Congressional intent that rates not be a factor in certificate cases, the legislative history of the 1942 amendments indicates that rates were to continue to be a factor in certificate cases in the same limited sense as under the original act;³⁸³ *i.e.*, consideration was to be given to the ability of a company proposing service *in an area already being served by another company* to render such service at lower rates than those of the other company. This was said to have been "specifically reserved"³⁸⁴ in section 7(g) of the act which provides: "Nothing contained in this section shall be construed as a limitation upon the power of the Commission to grant certificates of public convenience and necessity for service of an area already being served by another natural-gas company."³⁸⁵

mind in 1938." Johnson, *supra* note 378, at 775, 777. However, this commentator characterizes the act as "unilluminating," and observes that "the cold language of 1938 offers no guidance in resolving the pressing administrative problems that arose after 1954." *Id.* at 775.

³⁸⁰ Ch. 556, § 7(c), 52 Stat. 825 (1938).

³⁸¹ *Ibid.*

³⁸² 56 Stat. 83 (1942), 15 U.S.C. § 717f(c)-(g) (1958). The 1942 amendments were "based substantially" on the certification section of the Motor Carrier Act, 49 Stat. 551 (1935), as amended, 49 U.S.C. §§ 305, 306 (1958). *Hearings on H.R. 5249 Before the House Committee on Interstate and Foreign Commerce*, 77th Cong., 1st Sess. 5 (1941). The Supreme Court has indicated that the question of "illegal tariffs" is not properly an issue in certificate proceedings under the Motor Carrier Act. *American Trucking Ass'n v. United States*, 326 U.S. 77, 86-87 (1945).

³⁸³ *Hearings on H.R. 5249, supra* note 382, at 18-19.

³⁸⁴ *Id.* at 18.

³⁸⁵ 56 Stat. 84 (1942), 15 U.S.C. § 717f(g) (1958).

Further, there is a suggestion in the legislative history of the 1942 amendments that, with respect to *all* applications, such amendments would permit the Commission to "scrutinize," *inter alia*, "the *characteristics* of the rate *structure* at a time when such vital matters can be revised and modified as the public interest demands."³⁸⁶ This language, however, suggests an inquiry concerning the *form* in which proposed rates are cast by the applicant rather than the lawfulness of the *amount* of the proposed rates. Certainly such nebulous language in the legislative history of the 1942 amendments to section 7 cannot be effective to negate the apparent plan of the act that rate levels are to be modified only in section 4 or 5 proceedings.³⁸⁷

The logical conclusion to be drawn with respect to the *amount* of proposed rates as an issue in certificate cases under section 7 as amended in 1942 is that when confronted with the question of whether a pipeline applicant should be permitted to render new service in an area within "an area already being served by another natural gas company," *one factor* which must be considered is the ability of the applicant to render the service at rates lower than those of the other gas company. This limited inquiry has a relevance peculiar to pipelines³⁸⁸ and seems wholly inapplicable to producers.³⁸⁹

The first judicial approval of a Commission-imposed condition requiring a reduction in the initial rate proposed by a natural gas company was the *Signal* decision.³⁹⁰ In *Signal*, the court relied on

³⁸⁶ *Hearings on H.R. 5249*, *supra* note 382, at 6. (Emphasis added.) The other "vital matters" listed were (1) "financial set-up," (2) adequacy of gas reserves, and (3) feasibility of proposed services.

³⁸⁷ The same comment is applicable to another passing reference to "conditions affecting rates" found in the legislative history of the 1942 amendments. *Id.* at 24. See, e.g., *Highland Supply Corp. v. Reynolds Metals Co.*, 327 F.2d 725, 730 (8th Cir. 1964).

³⁸⁸ That all parts of the act are not equally applicable to producers and pipelines has been judicially recognized in a case holding that the portion of § 7(c) relating to temporary certificates (also introduced by the 1942 amendments) "has a special relationship to pipelines." *Public Serv. Comm'n v. FPC*, 327 F.2d 893, 896 (D.C. Cir. 1964).

³⁸⁹ As originally enacted, § 7(c) of the act (the rate provisions of which were said to be "reserved" in § 7(g) of the act) was intended to "prevent wasteful competition of natural gas companies." *Hearings on H.R. 5249*, *supra* note 382, at 4. This can have no application to producers, among whom strong competition exists *prior* to the time Commission certification is requested. The gas sale proposed is a *product* of that competition. It also should be noted that pipelines, not producers, are assigned "service areas" under § 7(f).

³⁹⁰ *Signal Oil & Gas Co. v. FPC*, 238 F.2d 771 (3d Cir. 1956), *cert. denied*, 353 U.S. 923 (1957), discussed in text accompanying notes 42-50 *supra*. In an earlier case, judicial approval was given to a certificate condition imposed by the Commission *prior* to the 1942 amendments requiring that the rate which a pipeline proposed to charge, on the basis of which authority to construct new facilities was granted, actually be charged by the pipeline throughout the term of the certificate. *Arkansas-Louisiana Gas Co. v. FPC*, 113 F.2d 281 (5th Cir. 1940), *affirming* 2 F.P.C. 546 (1939). In another case *after* the 1942 amendments, a Commission certificate order prescribing a rate other than the proposed rate as being "just, reasonable . . . and satisfactory to the Commission" was upheld because it was held to be within the scope of a condition imposed on the certificate authorizing construc-

(1) administrative interpretation by the Commission that it was authorized to impose "rate conditions" upon pipeline certificates; (2) the reference to rates in the legislative history of the 1942 amendments; and (3) a number of judicial decisions, none of which passed upon the power of the Commission to *reduce* by certificate condition the initial rate proposed by an applicant.³⁹¹ It must be conceded that there was Commission precedent in pipeline certificate cases for the imposition of "rate conditions" which required that tariffs satisfactory to the Commission be filed at some future date³⁹² or, in some instances, which actually required that proposed rates be reduced.³⁹³ In virtually all the cases in which proposed rates were reduced by the Commission, however, the proposed rates were expressly or implicitly found to be unjust, unreasonable, or discriminatory.³⁹⁴ In any event, this administrative precedent does not appear to have been sufficiently persuasive to override the specific provisions of the act. Although uniform administrative statutory interpretation is entitled to weight,³⁹⁵ it cannot be effective to enlarge the statutory authority of an administrative body in contravention of clear statutory language.³⁹⁶ That consistent administrative interpretation is not always conclusive is well illustrated by the *Phillips* case,³⁹⁷ in which the Supreme Court brushed aside the Commission's consistent prior interpretation that the

tion of facilities that "a tariff satisfactory to the Commission" be submitted six months before the beginning of operations; but the validity of the basic rate condition was conceded by the litigants, and, hence, was not before the court. *Alabama-Tennessee Natural Gas Co. v. FPC*, 203 F.2d 494 (3d Cir. 1953), affirming 11 F.P.C. 75 (1952).

³⁹¹ The strongest authorities cited by the court in *Signal* for the result it reached were the cases discussed *supra*, note 390.

³⁹² See, e.g., *Trunkline Gas Supply Co.*, 8 F.P.C. 250, 257 (1949); *Alabama-Tennessee Natural Gas Co.*, 7 F.P.C. 257 (1948), *satisfactory tariff determined*, 11 F.P.C. 75 (1952), *aff'd*, 203 F.2d 494 (3d Cir. 1953); *Transcontinental Gas Pipe Line Co.*, 7 F.P.C. 24, 39-40 (1948) (tariff "in a form" satisfactory to the Commission); *East Tennessee Natural Gas Co.*, 7 F.P.C. 5, 13 (1948); *Michigan-Wisconsin Pipe Line Co.*, 6 F.P.C. 1, 20 (1947) (schedule satisfactory "in form" to the Commission), *aff'd on other grounds sub nom. Panhandle Eastern Pipe Line Co. v. FPC*, 169 F.2d 881 (D.C. Cir. 1948), *cert. denied*, 335 U.S. 854 (1948).

³⁹³ See, e.g., *Erie Gas Serv. Co.*, 10 F.P.C. 22, 30, 34 (1951); *Transcontinental Gas Pipe Line Corp.*, 9 F.P.C. 32, 52, 63 (1950); *San Juan Pipe Line Co.*, 9 F.P.C. 170, 185, 196 (1950); *Tennessee Gas & Transmission Co.*, 4 F.P.C. 293, 301 (1945). *But cf. Commonwealth Natural Gas Corp.*, 9 F.P.C. 70, 82 (1950).

³⁹⁴ *Erie Gas Serv. Co.*, note 393 *supra*; *Transcontinental Gas Pipe Line Corp.*, note 393 *supra*; *San Juan Pipe Line Co.*, note 393 *supra*; *Tennessee Gas & Transmission Co.*, note 393 *supra*. In this connection, it should be noted that unlike in producer certificate cases, cost estimates are an essential part of the applicant's case in pipeline proceedings. Hence, information for determining the probable lawfulness of rates proposed for the service to be rendered through the new facilities is readily available to the Commission.

³⁹⁵ E.g., *Sunray Mid-Continent Oil Co. v. FPC*, 364 U.S. 137, 154 (1960); *Panhandle Eastern Pipe Line Co. v. FPC*, 232 F.2d 467, 471 (3d Cir. 1956), *cert. denied*, 352 U.S. 891 (1956).

³⁹⁶ E.g., *Social Security Bd. v. Nierotka*, 327 U.S. 358, 369 (1946); *Pacific Power & Light Co. v. FPC*, 184 F.2d 272, 275 (D.C. Cir. 1950); *United States v. Youngstown Sheet & Tube Co.*, 171 F.2d 103, 110 (6th Cir. 1948).

³⁹⁷ *Phillips Petroleum Corp. v. Wisconsin*, 347 U.S. 672 (1954).

act was not applicable to producers with the comment that "even consistent error is still error."³⁹⁸

In *CATCO*,³⁹⁹ the Supreme Court did not cite *Signal* or other judicial authority, and did not rely on the language of the act, its legislative history, or its interpretation by the Commission; instead, the Court relied on the "purpose" of the act in holding that producers must show their initial rates to be required by public convenience and necessity. The Court read this requirement into the act because it believed (1) that the purpose of the act was "to underwrite just and reasonable rates to the consumers of natural gas"⁴⁰⁰ and "to afford consumers a complete, permanent and effective bond of protection from excessive rates and charges,"⁴⁰¹ and (2) that this purpose would be frustrated unless initial rates were shown to be required by public convenience and necessity. Although it conceded that initial rates need not be shown to be just and reasonable in certificate proceedings, nevertheless the Court imposed a new and additional test of the lawfulness of initial rates which must be met in such proceedings, a test nowhere expressed in the act.

The Court attempted to square *CATCO* with its prior interpretation of the Commission's authority with respect to rates:⁴⁰² "In granting such conditional certificates, the Commission does not determine initial prices nor does it overturn those agreed upon by the parties. Rather, it so conditions the certificate that the consuming public may be protected while the justness and reasonableness of the price fixed by the parties is being determined under other sections of the act."⁴⁰³ These words, however, are unconvincing to a gas producer who has been precluded by a Commission condition from collecting the initial price prescribed by his contract. It seems specious to contend that the Commission does not "determine" the initial price of a sale if it requires as a condition to certification that the initial price not exceed a level several cents below that prescribed by the contract rate schedule.

Nor is this contention strengthened by the fact that a producer may immediately file a *rate increase* up to the initial contract price, subject to the limitations of section 4.⁴⁰⁴ A producer filing such an increase is faced with the possibility that the Commission will sus-

³⁹⁸ *Id.* at 678 n. 5.

³⁹⁹ *Atlantic Ref. Co. v. Public Serv. Comm'n*, 360 U.S. 378 (1959), discussed in text accompanying notes 34 and 99-139 *supra*.

⁴⁰⁰ *Id.* at 388.

⁴⁰¹ *Ibid.*

⁴⁰² See text accompanying notes 370-374 *supra*.

⁴⁰³ 360 U.S. at 392.

⁴⁰⁴ 52 Stat. 822 (1938), as amended, 15 U.S.C. § 717c (1958).

pend the effectiveness of the increase for a time up to five months and, hence, that contractually authorized revenues will be irretrievably lost.⁴⁰⁵ Furthermore, this mechanism effectively destroys the presumption of validity with which the act appears to endow rates initially established by regulated companies and filed with the Commission because the burden of proof in a section 4(e) proceeding is upon the producer.⁴⁰⁶ A fortiori, there is no validity in the position that the Commission does not "determine" initial rates in those cases in which it attaches a rate-reducing condition coupled with a moratorium on rate increases.

The upshot of the Supreme Court's reading of the act in *CATCO*⁴⁰⁷ is that initial rates filed by gas producers may be subject to two tests of lawfulness instead of the one specifically prescribed by the act and that, when initial rates are subjected to these tests, the burden is upon the producer to show that the initial rates proposed meet each test. And, contrary to the Supreme Court's observation, the initial rate, *i.e.*, the rate charged for first deliveries of gas, is *not* determined by the producers, but by the Commission.⁴⁰⁸ Under the *CATCO* gloss the only efficacy of the initial rate prescribed by contract is as a ceiling which the initial rate cannot exceed.⁴⁰⁹

The two-step procedure sanctioned by the Supreme Court in *CATCO* destroys the difference between initial rates and changed rates contemplated by the structure of the act. The Court told the Commission that it could use its section 7 conditioning power to compel producers to subject a portion of their initial rates to the provisions of sections 4(d) and 4(e) (or forever lose such portion) notwithstanding the fact that the language of the act makes it clear that sections 4(d) and 4(e) were intended to apply not to initial rates but to *changes in previously filed rates*. The Court suggested this

⁴⁰⁵ Revenues which a natural gas company is prohibited from collecting by a Commission suspension order cannot thereafter be recouped even though the increased rate is ultimately determined to be just and reasonable. *FPC v. Tennessee Gas Transmission Co.*, 371 U.S. 145 (1962); *Hope Natural Gas Co. v. FPC*, 196 F.2d 803 (4th Cir. 1952).

⁴⁰⁶ The burden of proving in a § 5(a) proceeding that an existing rate is unlawful is upon the one urging such unlawfulness. See *Sunray Mid-Continent Oil Co. v. FPC*, 364 U.S. 137, 144 (1960); *Bel Oil Corp. v. FPC*, 255 F.2d 548, 554 (5th Cir. 1958), *cert. denied*, 358 U.S. 804 (1958).

⁴⁰⁷ *Atlantic Ref. Co. v. Public Serv. Comm'n*, 360 U.S. 378 (1959).

⁴⁰⁸ See Munn, *The Lesson of the Independent Gas Producer Regulatory Experiment*, ABA Proceedings, Section of Mineral & Natural Resource Law 17, 27 (1961).

⁴⁰⁹ See *United Gas Pipe Line Co. v. Mobile Gas Serv. Corp.*, 350 U.S. 332 (1955). One writer has suggested that this limitation on rates be eliminated by permitting producers to file tariffs. Steves, *FPC Gas Tariff—Solution to the Rate Change Dilemma of the Independent Producer?*, 15 Sw. L.J. 46 (1961). In this connection, another writer has observed that if producers are to be subjected to "the burdens of regulation, . . . the benefits should also be available." Tarver, *The Natural Gas Regulatory Problem—A Middle Way*, ABA Proceedings, Section of Mineral & Natural Resource Law 15, 17 (1961).

violation of the act's apparent intent in order to devise a hybrid procedure which it thought necessary to the proper administration of the act.

It is submitted that if standards or procedures not provided for in the act became necessary after 1954, it was the function of Congress, not the courts or the Commission, to supply them. Although some degree of "interstitial" legislation by courts and administrative bodies is inevitable,⁴¹⁰ administrative boards should not assume major substantive authority not specifically provided in the applicable statute, nor should the courts, whose function is to interpret statutes, not amend them, attribute such authority to an administrative board.⁴¹¹ The Supreme Court has said that in ascertaining the functions and authority of an administrative board, "the determinative question is not what the Board thinks it should do but what Congress has said it can do."⁴¹² Concerning problems of administration, the Court has said:

Legislation introducing a new system is at best empirical, and not infrequently administration reveals gaps or inadequacies of one sort or another that may call for amendatory legislation. But it is no warrant for extending a statute that experience may disclose that it should have been more comprehensive. "The natural meaning of words cannot be displaced by reference to difficulties in administration." . . . For the ultimate question is what has Congress commanded.⁴¹³

Administrative bodies, supported by the courts, should have and

⁴¹⁰ That the Commission is disposed to exercise legislative power which is considerably broader than "interstitial" was shown in striking fashion in a recent case in which the Commission held subject to its jurisdiction sales to consumers in Louisiana of gas produced in Louisiana. *United Gas Pipe Line Co.*, 30 F.P.C. 560 (1963). Unable to find anything in the language of the act or its legislative history supporting its jurisdiction over these sales, the Commission said:

In the absence of a direct statement of what Congress intended, we must attempt to determine what Congress would have said about this particular problem if it had been brought to its attention. We do not think it is sufficient to ask simply whether the states could constitutionally have regulated the sales at issue here. Rather we are compelled to ask whether a statutory scheme which would include wholesale sales at one end of a pipeline but would exclude the same sales, from a common stream, if made at the other end of a pipeline, would make sense. We think it would not. . . . We conclude that had Congress considered the sales here in question, it would have treated them as "in interstate commerce." *Id.* at 567-68. (Emphasis added; footnotes omitted.)

Regrettably, in recent years the Supreme Court has occasionally utilized similar reasoning in construing legislation. *E.g.*, *NLRB v. Fruit & Vegetable Packers, Local 760*, 377 U.S. 58 (1964); *Rosenberg v. Fleuti*, 374 U.S. 449 (1963).

⁴¹¹ See, *e.g.*, *CAB v. Delta Air Lines, Inc.*, 367 U.S. 316, 322 (1961); *Addison v. Holly Hill Fruit Prods., Inc.*, 322 U.S. 607, 617-18 (1944); *Mississippi River Fuel Corp. v. FPC*, 202 F.2d 899, 903 (3d Cir. 1953), *appeal dismissed*, 345 U.S. 988 (1953); *Border Pipe Line Co. v. FPC*, 171 F.2d 149, 152-53 (D.C. Cir. 1948).

⁴¹² *CAB v. Delta Air Lines, Inc.*, *supra* note 411, at 322.

⁴¹³ *Addison v. Holly Hill Fruit Prods., Inc.*, 322 U.S. 607, 617-18 (1944).

should exercise all *incidental* and *subsidiary* powers necessary to implement the basic powers specifically conferred upon them. Their authority should not, however, be extended by "implication" to include new basic substantive powers not specified in the relevant statute. It is logically, as well as legally, unsound to argue that because expressly granted powers A and B can be said to manifest or promote policy X, that all other powers which also can be said to manifest or promote policy X have been impliedly granted. By this line of "reasoning" almost anything could be read into any statute. Predictability is not an outmoded attribute of the law. If statutory authority is to be extended to cover everything promotive of the broad policies found in a statute, one would do well to challenge all proposed legislation.

The undesirability of the "broad legislative policy" approach to statutory construction is demonstrated by the fact that several broad policies, sometimes conflicting, often can be found in a single statute. For example, the Supreme Court has stated that in addition to the oft-recognized policy of protecting consumers, Congress was manifesting in the Natural Gas Act "its concern for the legitimate interests of natural gas companies in whose financial stability the gas-consuming public has a vital stake."⁴¹⁴ Certainly this particular legislative policy is not promoted by permitting natural gas companies to be deprived forever of contractually authorized revenues which have not been shown to be unlawful so that consumer gas bills may be reduced. Under the approach in question, if such a conflict in policies is presented, the result will depend on which policy the court or administrative body thinks should take precedence. In our system of government, such a decision is properly a function of Congress. The virtue of deciding the matter upon the basis of what the statute says seems apparent.

b. *Application of CATCO*

Notwithstanding the foregoing discussion, CATCO⁴¹⁵ is a *fait accompli* which must be dealt with as a significant amendment of the act. Although characterized by one writer as "a guiding flare in a field of otherwise utter darkness,"⁴¹⁶ the description of the Commission's efforts to apply this decision⁴¹⁷ makes it apparent that the light from this "flare" was not altogether unfailing, and was never particularly bright. Having described the Commission's current ap-

⁴¹⁴ *United Gas Pipe Line Co. v. Memphis Light, Gas & Water Div.*, 358 U.S. 103, 113 (1958).

⁴¹⁵ *Atlantic Ref. Co. v. Public Serv. Comm'n*, 360 U.S. 378 (1959).

⁴¹⁶ Johnson, *supra* note 378, at 773.

⁴¹⁷ See text following note 139 and accompanying notes 140-196 *supra*.

plication of *CATCO* and the evolution thereof,⁴¹⁸ it is appropriate to access the Commission's approach in the light of the "guiding flare."

(1) *The Out of Line Test* Certainly the most celebrated and legally significant aspect of the *CATCO* decision was the pronouncement of the "out of line" test.⁴¹⁹ As has been shown previously, judicial and Commission decisions have resolved the question of whether an initial rate is lawful as measured by the test of public convenience and necessity into a determination of whether such price is above or below a precise and virtually frozen number known as the "line." The language of the *CATCO* opinion, however, conveys the distinct impression that the Supreme Court did not have this kind of rigidity in mind when it used the term "out of line."⁴²⁰ Rather, as Judge Brown observed,⁴²¹ it would seem that the term was merely a colloquial expression used by the Court for purposes of convenience and was not intended as the phrase of art it has become. The phrase "out of line" is in common use and has a generally accepted meaning. When applied to a price, the phrase could mean either that it is too high or too low, depending on the observer's viewpoint.⁴²² Read in the context of the *CATCO* opinion, the "out of line" test would appear to involve only the question of whether a price is too high from the viewpoint of the buyer, considering all surrounding circumstances.

What is the proper test of whether a proposed price is "out of line," *i.e.*, too high, in the *CATCO* sense? As has been noted previously, the Supreme Court was not very helpful on this point.⁴²³ Factors specifically mentioned by the Court as requiring more evidence than was in the record were: (1) the price was higher than any paid by the purchaser, (2) the price was seventy per cent higher than the weighted average cost of gas to the purchaser, and (3) the

⁴¹⁸ See text accompanying notes 356-362 *supra*.

⁴¹⁹ 360 U.S. at 391. The other two *CATCO*-prescribed indicia that a proposed price "is not in keeping with the public interest," *viz.*, its "triggering of general price rises" and its causing "an increase in the applicant's existing rates by reason of 'favored nation' clauses or otherwise," have not been significant factors in the law that has evolved. The only case found in which controlling effect was given these tests is *Western Natural Gas Co.*, 23 F.P.C. 332, 11 O. & G.R. 1074 (1960), discussed in text accompanying notes 170-172 *supra*. See Johnson, *supra* note 378, at 811-13.

⁴²⁰ *But cf.* Johnson *supra* note 378, at 798.

⁴²¹ *United Gas Improvement Co. v. FPC*, 290 F.2d 133, 138 (5th Cir. 1961), discussed in text accompanying notes 236-244 *supra*.

⁴²² In this connection, the use of the phrase "out of line" by American Airlines, in an advertisement appearing on page 9 of the January 3, 1964, issue of the *Wall Street Journal* is of interest. There, in announcing a voluntary reduction in first-class fares, American stated that the cost of first-class accommodations had been so much higher than coach that American "felt it was *out of line*." (Emphasis added.) Clearly, the meaning conveyed was that, all factors considered, the first-class fares were too high.

⁴²³ See text accompanying notes 133-139 *supra*.

price was "greatly in excess of" the price paid by the purchaser for gas from any lease in southern Louisiana.⁴²⁴ The Court indicated that these factors made it necessary for the applicant to introduce evidence showing a "reason why" the proposed prices were higher than those with which they had been compared, and made it clear that information which was "little more . . . than was included in the printed contracts"⁴²⁵ was not sufficient for this purpose. The only evidence which the Court specifically mentioned as appropriate for this purpose was evidence of "relative costs of production."⁴²⁶ Another factor which influenced the Court was the purchaser's construction of a pipeline to the producers' wells and the free transportation of the producers' distillates. The absence of support for these aspects of the transaction in the form of "evidence of practice or custom"⁴²⁷ or other supporting data was stressed.

The vagueness of the Supreme Court's definition of the "out of line" test left considerable latitude for administrative interpretation. Nevertheless, some elements seem clear. The test calls initially for a comparison of a proposed price with other prices. The comparison must be made with prices at which comparable sales are made, or allowance must be made for factors which are not comparable.⁴²⁸ If the price in question exceeds prices under sales with which comparison is made, taking into account aspects of noncomparability, a price condition "may" be attached to the certificate issued *unless evidence is presented showing a "reason why" the excess price is required by public convenience and necessity*. No restriction was suggested by the Court with respect to the *kind* of evidence which may be adduced for this purpose.

As has been noted, the Commission's inquiry is generally restricted to a comparison of the proposed price with other prices in an artificially delineated area. Although this subject cannot be explored at length here, it is apparent that political boundary lines should be of no moment in determining areas within which gas prices are to be compared.⁴²⁹ The areas of comparison should have some rational foundation in the economics of the gas industry. It is as ridiculous for gas produced from a single source of supply to be sold at different prices because drawn from wells located on different sides of a county

⁴²⁴ Atlantic Ref. Co. v. Public Serv. Comm'n, 360 U.S. 378, 392-93 (1959).

⁴²⁵ *Id.* at 392.

⁴²⁶ *Id.* at 393.

⁴²⁷ *Ibid.*

⁴²⁸ See United Gas Improvement Co. v. FPC, 283 F.2d 817 (9th Cir. 1960), *cert. denied*, 365 U.S. 881 (1961).

⁴²⁹ See McGee, *Independent Producers—After Six Years of FPC*, ABA Proceedings, Section of Mineral & Natural Resource Law 219, 233-234 (1960).

line⁴³⁰ as it is to have multiple just and reasonable rates from a single well.⁴³¹ It would appear that the areas of comparison currently used by the Commission are generally too small. Conceivably, comparisons could be made on a nation-wide basis, if appropriate account were taken of factors peculiar to sales in each area.

Further, it would appear that the Commission is much too restrictive in selecting prices within a given area to which it will give weight in determining whether a proposed price is "out of line." By giving little or no weight to nonjurisdictional prices, prices received by gathering companies, prices received by new pipelines, prices under contracts executed substantially before or after the contracts in issue, "suspect" prices, "like-suspect" prices, and prices under temporarily certificated sales, the Commission has effectively deprived the "out of line" test of any semblance of reality. Nothing in CATCO⁴³² suggests that prices be measured in section 7⁴³³ proceedings by an artificially contrived standard which can be tailored to support any predetermined result. On the contrary, the gist of the "out of line" test to be gathered from CATCO is that an initial price above the prevailing market price should not be permitted by the Commission absent a legally compelling explanation therefor. It follows that *all* prices at which gas is sold in the area of comparison should be considered in determining whether a price is "out of line."

At most, CATCO indicates that the *status quo* should be maintained against unjustified price increases; there is no hint that certificate procedures should be utilized to effect a price freeze or a price rollback. The cutoff point for determining the existing market level against which a proposed price is to be measured should be the time of closing the record in the certificate proceeding in which the price is being tested. There is no valid reason for limiting consideration to prices under contracts executed contemporaneously with those in issue. The touchstone of public convenience and necessity should be an objective one to the greatest extent possible, and whether or not the negotiators of a price were influenced by a particular contract should not determine whether the initial price prescribed by such contract should be considered in appraising the lawfulness of a price in question. The relevant inquiry in a certificate proceeding ought to be what *is* the *status quo*, not what *was* the *status quo* at some time in the past, or *what would it have been* if regulatory actions

⁴³⁰ See Michigan-Wisconsin Pipeline Co., 27 F.P.C. 449 (1962), discussed in text accompanying notes 285-288 *supra*.

⁴³¹ See Phillips Petroleum Co., 24 F.P.C. 537, 544, 13 O. & G.R. 343, 350 (1960).

⁴³² Atlantic Ref. Co. v. Public Serv. Comm'n, 360 U.S. 378 (1959).

⁴³³ 52 Stat. 824 (1938), as amended, 15 U.S.C. § 717f (1958).

which were not taken had been taken.⁴³⁴ If this approach presents a possibility of "unjust enrichment" to sellers as a result of procedural delays in a period of rising market prices, it also presents the possibility of a price penalty in a period of declining market prices.

In addition to the weight they should be given as manifestations of the current market price, prices for gas sold in intrastate commerce⁴³⁵ and in other nonjurisdictional markets are entitled to consideration in section 7 proceedings for another reason. The "public" whose "convenience and necessity" is of concern to the Commission is, of course, that segment of the population using gas sold in interstate commerce. But this "public" is affected by the price paid for nonjurisdictional gas to the extent such price attracts, or presents the possibility of attracting, gas supplies away from the interstate market.⁴³⁶ It is not suggested that controlling significance be given nonjurisdictional prices, but it seems apparent that the "convenience and necessity" of the interstate "public" requires that interstate gas prices be allowed to remain high enough to keep needed gas supplies from being diverted to intrastate or other nonjurisdictional sales.⁴³⁷

There appears to be no valid basis for the Commission's refusal to give weight to prices paid by pipelines to gathering companies. Whether the gathering is done by the producer or by an intervening entity should not be legally significant. The ultimate question is the price paid by the pipeline measured against the value received therefor. If a proposed price is applicable to gas delivered by a producer at the wellhead, a sale by a gathering company can be used for comparative purposes if an appropriate adjustment is made for the value of the gathering function.

(2) *Suspect Prices* One of the most objectionable aspects of the Commission's current approach to the initial rate issue is the exclusion of so-called "suspect prices" and "like-suspect" prices in determining whether a price is "out of line."⁴³⁸ The "suspect price" rule runs afoul of the long-established and well-founded rule of law that orders of the Federal Power Commission and other administrative agencies are

⁴³⁴ See *Callery Properties, Inc. v. FPC*, 335 F.2d 1004, 1013 n. 24 (5th Cir. 1964).

⁴³⁵ Intrastate prices have on occasion been given weight by the Commission. See, e.g., *Phillips Petroleum Co.*, 22 F.P.C. 528, 529 (1959), discussed in text accompanying and following notes 160-162 *supra*.

⁴³⁶ In one case, gas producers refused price-conditioned certificates, took their gas off the interstate market, and sold it intrastate at a price above that which the Commission had imposed. *Gulf Oil Corp.*, 23 F.P.C. 664 (1960), *rescinded*, 23 F.P.C. 926 (1960), discussed in text accompanying notes 179-185 *supra*.

⁴³⁷ See *Johnson*, *supra* note 378, at 801.

⁴³⁸ For a detailed analysis of this subject, see *Morris, Recent Independent Producer Certificate Cases: The "Suspect Order" Rule*, 32 Geo. Wash. L. Rev. 489 (1964).

presumptively valid.⁴³⁹ As the Supreme Court observed in one leading case,⁴⁴⁰ an order of the Commission is "the product of expert judgment" and "does not become suspect by reason of the fact that it is challenged."⁴⁴¹ The Ninth Circuit, however, in first announcing the "suspect price" rule,⁴⁴² completely ignored this presumption of validity.

The "suspect price" rule not only fails to accord certificate orders the presumption of validity to which they are entitled under settled law, it also has potential consequences far more "anomalous" than those which the Ninth Circuit said it feared would flow from reliance on prices under review (and "like" prices) when determining whether a particular price was "out of line." The application of this rule necessarily prevents the price "line" against which a proposed price is to be measured from representing current conditions in the industry as the Ninth Circuit itself said it should.⁴⁴³ Unwarranted power is placed in the hands of those who oppose a particular price level because they may effectively freeze the price "line" at old levels simply by challenging every Commission order certificating sales at higher prices.⁴⁴⁴

Carried to its logical end, the "suspect" price rule is administratively unworkable. If all prices under judicial or Commission review (and all "like" prices) were discarded as irrelevant for the purpose of testing initial prices, there soon would be no jurisdictional prices with which comparison could be made. This is so because as area rate proceedings are instituted with respect to the various gas producing areas of the country, *all* such prices will be subject to Commission review, and therefore "suspect."⁴⁴⁵ The effect would be to destroy completely the "out of line" concept. A result more at odds with CATCO⁴⁴⁶ hardly can be imagined.

(3) *Exclusion of Evidence* Equally as objectionable as the "suspect" price rule is the Commission's present policy of excluding all

⁴³⁹ *FPC v. Hope Natural Gas Co.*, 320 U. S. 591 (1944); *Panhandle Eastern Pipeline Co. v. FPC*, 179 F.2d 896 (8th Cir. 1950); *Colorado Interstate Gas Co. v. FPC*, 142 F.2d 943 (10th Cir. 1944).

⁴⁴⁰ *FPC v. Hope Natural Gas Co.*, *supra* note 439.

⁴⁴¹ *Id.* at 602. (Emphasis added.)

⁴⁴² *United Gas Improvement Co. v. FPC*, 283 F.2d 817 (9th Cir. 1960), *cert. denied*, 365 U.S. 881 (1961), discussed in text accompanying notes 217-227 *supra*.

⁴⁴³ In receding somewhat from this rule recently, the Commission recognized that rigid application of the rule would "result in a *complete stagnation* of prices at . . . a level based on prices being paid for gas under contracts drawn up long before these contracts were executed." *Amerada Petroleum Corp.*, No. 422, FPC, March 23, 1964, *rehearing denied*, No. 422A, FPC, May 27, 1964 (Emphasis added.), discussed in text accompanying notes 348-355 *supra*.

⁴⁴⁴ This weakness in the rule has been conceded by the Commission. *Texaco Seaboard, Inc.*, 29 F.P.C. 593, 598, 17 O. & G.R. 874, 881 (1963), discussed in text accompanying notes 312-317 *supra*.

⁴⁴⁵ See *Atlantic Ref. Co. v. FPC*, 316 F.2d 677, 680 n. 12 (D.C. Cir. 1964).

⁴⁴⁶ *Atlantic Ref. Co. v. Public Serv. Comm'n*, 360 U.S. 378 (1959).

cost, economic, and related evidence. The exclusion of this evidence in combination with the application of the "suspect" order rule has sapped certificate proceedings of all vitality and meaning. Virtually nothing can be adduced by a producer in a certificate proceeding that will support a price above the highest price in the area not subject to review proceedings. The Commission's exclusion of evidence relating to costs, economics, geology, and related matters is entirely contrary to *CATCO* because it effectively eliminates the possibility of showing a "reason why" in support of a proposed price, the absence of which was fatal to the prices proposed in *CATCO*.⁴⁴⁷ That *CATCO* specifically refers to relative costs of production as evidence that might have been presented as a "reason why" apparently has been forgotten.⁴⁴⁸

The requirement of *CATCO* that prices above current levels be supported by a showing of a "reason why,"⁴⁴⁹ combined with the Commission's exclusion of all evidence which can be presented to make such a showing, puts producers in an intolerable position and leads to an absolute price freeze which cannot be thawed.⁴⁵⁰ The fact that the evidence also may be relevant in determining just and reasonable rates does not necessarily establish that such evidence is not relevant in determining whether a proposed price is required by public convenience and necessity. It is true, of course, that the public convenience and necessity standard as applied to prices implies an appraisal based primarily on the worth of a particular gas sale to the consuming public. Consequently, the emphasis in certificate cases is properly on the aspects of a sale which make it more valuable, or less valuable, to the purchaser and to the consuming public.⁴⁵¹ If the prevailing price in a particular area for gas delivered at the wellhead is 20 cents per Mcf, there having been no prior sales in the area of gas delivered to the purchaser's main line, the primary inquiry in testing a 20.5 cent price for gathered gas should be how much is the pipeline advantaged by the gathering service performed by the

⁴⁴⁷ *Ibid.* Since the burden of supporting initial prices above current levels with a "reason why" has been imposed on producers, it seems axiomatic that the Commission is without authority to exclude all evidence which can be presented for that purpose. See *American Trucking Ass'n v. United States*, 326 U.S. 77, 83-86 (1944).

⁴⁴⁸ 360 U.S. at 392-93.

⁴⁴⁹ 360 U.S. at 393.

⁴⁵⁰ When applied in combination with the "suspect" price rule, the Commission's exclusion of evidence actually results in a price rollback to old levels rather than in a freeze at current levels.

⁴⁵¹ In two recent cases, the Commission has articulated this concept in refusing to allow price increments to producers as reimbursement for the cost of transporting their gas to the purchasers' pipelines. *Superior Oil Co.*, No. 437, FPC, July 23, 1964; *Amerada Petroleum Corp.*, No. 422, FPC, March 23, 1964, *rehearing denied*, No. 422A, FPC, May 27, 1964.

seller, not how much does the service cost the seller.⁴⁵² The logical measure of the value of this particular service would be the amount it would cost the purchaser to perform the service. No matter how relevant the seller's cost of this service might be in determining whether the price he receives is just and reasonable, it is of little significance in determining whether a price differential based on such service is necessary and convenient to the public.

But this primary emphasis on value does not rule out cost and economic factors. The convenience and necessity to the public is not dependent *entirely* on whether a particular price is above other prices, taking into account the factors which affect the value of the sales being compared; it also is relevant to inquire whether the price in question is sufficiently high to spur the development of needed future supplies in the area.⁴⁵³ In this connection it should be noted that the statutory standard is "the present or *future*"⁴⁵⁴ public convenience and necessity. The public is not benefitted, except in the very short run, by low prices which will not bring forth supplies needed for the future. For this purpose, the cost and economic evidence currently being rejected by the Commission is not only appropriate in certificate cases; it is well nigh essential. Such evidence should not be presented to show that the price in question is or is not just and reasonable, but to show that it is required to provide needed supplies, *i.e.*, to show that the price is required by present or future public convenience and necessity.

In a recent case,⁴⁵⁵ the Fifth Circuit reversed a Commission order issuing rate-conditioned certificates because the Commission rejected cost and financial evidence presented by the producers. The court's opinion on this point was in substantial agreement with the views expressed above.

(4) *Function of Policy Statement* As previously noted,⁴⁵⁶ the Commission has recognized in recent cases that the Policy Statement⁴⁵⁷ cannot be determinative of the substantive rights of any certificate applicant. This would seem to rule out the use of Policy Statement rates in contested cases as "ceilings" or as "administrative

⁴⁵² But cf. *Panhandle Eastern Pipe Line Co.*, 27 F.P.C. 35, 45, 15 O. & G.R. 877, 891 (1962), discussed in text accompanying notes 263-270 *supra*.

⁴⁵³ Mr. Justice Jackson once observed that "if . . . the price is not a sufficient incentive to exploit [the supply of gas] . . . and fails to bring forth the quantity needed, the price is unwisely low. . . ." *Colorado Interstate Gas Co. v. FPC*, 324 U.S. 581, 612 (1944) (concurring opinion).

⁴⁵⁴ 56 Stat. 84 (1942), 15 U.S.C. § 717f(e) (1958).

⁴⁵⁵ *Callery Properties, Inc. v. FPC*, 335 F.2d 1004 (5th Cir. 1964), discussed in text accompanying and following notes 331-337 *supra*.

⁴⁵⁶ See text preceding and accompanying note 361 *supra*.

⁴⁵⁷ Statement of General Policy No. 61-1, 24 F.P.C. 818, 12 O. & G.R. 1227 (1960).

determinations of the 'line.' ” The Policy Statement, however, could be treated as establishing an administrative presumption (not “determination”) that the initial prices which it specifies are required by public convenience and necessity.⁴⁵⁸ All prices below these levels would be presumed lawful as measured by the criterion of public convenience and necessity, and, in the absence of objections by interveners, would be approved in shortened proceedings. Objecting interveners in such a case would have the burden of proving that the price was not required by public convenience and necessity.⁴⁵⁹ Proposed prices exceeding the Policy Statement price would be presumed to be inconsistent with public convenience and necessity to the extent of the excess, and the burden of proving the contrary would be upon the applicants.

For such a scheme to work accurately and fairly, Policy Statement prices should be realistic and up-to-date, and should take account of all factors which may vary from sale to sale and which may affect the value of a particular sale to a particular buyer. These prices should be based on information presented in contested certificate proceedings and on other information on file with the Commission. They should change as circumstances change or as information becomes more complete and accurate. The attributes of the sales upon which the Policy Statement prices are founded should be set forth in detail, and both penalties and premiums should be prescribed for specified factors affecting the value of a sale, subject to the right of any party to show in an individual proceeding that different values should be attributed to such factors.

The function of Policy Statement prices discussed above is precisely the function which the Commission in the Policy Statement said such prices would serve. However, as has been shown, the Commission on occasion has applied those prices as determinations of the “line” or as impenetrable “ceilings.” The Commission’s tendency of late to treat Policy Statement prices as mere “guides” to future administrative action appears to be more in accord with the stated intent of the Policy Statement. It would appear that this is the *only* use to which such prices lawfully can be put.

(5) *Moratorium on Rate Increases* The Commission’s use of its conditioning power in recent cases to require a moratorium on the filing of rate increases over a specified level for gas sold under permanent certificates seems clearly at odds with the act. As has been men-

⁴⁵⁸ See Hillyer, *A Primer on Producer Price Regulation*, Oil and Gas Operations: Legal Considerations in the Tidelands and on Land 345, 363 (Slovenko ed. 1963).

⁴⁵⁹ See Stone, *Federal Power Commission Developments of Significance to Independent Producers of Natural Gas*, 13 Ann. Inst. on Oil and Gas Law and Taxation 1, 10-11 (1962).

tioned, section 4(c)⁴⁶⁰ of the act requires that natural gas companies file with the Commission schedules showing all rates and charges for sales subject to its jurisdiction. Under section 4(d),⁴⁶¹ a change in a filed rate may be made only upon thirty days' notice to the Commission and the public, to be given by the filing of a new schedule setting forth the new rate and the date it is to become effective. At any time during the thirty-day notice period, under section 4(e)⁴⁶² the Commission may (1) enter upon a hearing concerning the lawfulness of the new rate and (2) "pending such hearing," defer use of the new rate for a period of five months⁴⁶³ after it otherwise would have gone into effect. If the hearing has not been concluded at the end of the suspension period, the new rate may be put into effect subject to the Commission's power to require a refund of any portion found by the Commission to be unjustified.

It seems clear that these provisions of section 4 are, as the Supreme Court observed in *United Gas Pipe Line Co. v. Mobile Gas Serv. Corp.*,⁴⁶⁴ only procedural limitations on the power of natural gas companies to initiate rate changes. These limitations are necessary to permit the Commission to perform its only function under the act with respect to rates—that of reviewing the lawfulness of rates made by the companies. Nothing in the act can be said to support restriction of the freedom of natural gas companies to file any rate increase permitted by their gas supply contracts. On the contrary, it would appear, as the Supreme Court observed in *United Gas Pipe Line Co. v. Memphis Light, Gas & Water Div.*,⁴⁶⁵ that section 4 contemplates "the earliest effectuation of contractually authorized . . . rate changes consistent with appropriate Commission review."⁴⁶⁶

This view has been reflected in several cases⁴⁶⁷ in which the Commission was held to have no authority under the act summarily to reject contractually authorized rate increases duly filed by natural gas companies. In one of these cases,⁴⁶⁸ it was argued that the Com-

⁴⁶⁰ 52 Stat. 822 (1938), 15 U.S.C. § 717c(c) (1958).

⁴⁶¹ 52 Stat. 822 (1938), 15 U.S.C. § 717c(d) (1958).

⁴⁶² 52 Stat. 822 (1938), as amended, 15 U.S.C. § 717c(e) (Supp. IV, 1962).

⁴⁶³ The Commission has unsuccessfully urged Congress to increase this period. 42 FPC Ann. Rep. 16 (1962). The moratorium in question accomplishes this purpose indirectly by deferring the use of rate increases for a period of several years.

⁴⁶⁴ 350 U.S. 332 (1956).

⁴⁶⁵ 358 U.S. 103 (1958).

⁴⁶⁶ *Id.* at 114.

⁴⁶⁷ *Willmut Gas & Oil Co. v. FPC*, 294 F.2d 245 (D.C. Cir. 1961), *cert. denied*, 368 U.S. 975 (1962); *Mississippi River Fuel Corp. v. FPC*, 202 F.2d 899 (3d Cir. 1953), *appeal dismissed*, 345 U.S. 988 (1953). *But cf.* *Amerada Petroleum Corp. v. FPC*, 293 F.2d 572 (10th Cir. 1961), *cert. denied*, 368 U.S. 976 (1962); *Panhandle Eastern Pipe Line Co. v. FPC*, 232 F.2d 467, 473 (3d Cir. 1956); *Alabama-Tennessee Natural Gas Co. v. FPC*, 203 F.2d 494, 497 (3d Cir. 1953).

⁴⁶⁸ *Willmut Gas & Oil Co. v. FPC*, *supra* note 467.

mission should have prohibited the filing of rate increases pursuant to its section 16 rule-making power, a power which is certainly as broad as, if not broader than, the Commission's section 7(e) conditioning power. In rejecting this argument, the court said:

[T]he broad power granted by this statutory language does not authorize an order, rule, or regulation which would nullify or restrict the right of a natural gas company to change the rates under which it offers to furnish service, subject only to the requirements of Section 4(d) of the Act that it notify the Commission of the changes, so that it may proceed under Section 4(e). . . . An order or regulation requiring the rejection of increased rates . . . would deny to United the right to change rates at which it offers service, which the Mobile decision says is the right of a natural gas company. *Thus, it seems clear that such an order or regulation would amount to a legislative change which is beyond the authority of the Commission.*⁴⁶⁹ (Emphasis added.)

This interpretation of the act seems sounder than the contrary rationale of the Supreme Court in a recent case involving the Commission's rule-making power.⁴⁷⁰

In each case in which a moratorium on price increases has been imposed, the Commission has taken the position that such a condition was required by CATCO⁴⁷¹ because (1) any increase above the specified limit would cause widespread "triggering" of price increases resulting in a general increase of the "asking price" within the area, and (2) the obligation of the producer to refund amounts collected and later determined to be excessive does not adequately protect the public. In support of the latter point, the Commission has relied on a Supreme Court decision⁴⁷² upholding an interim rate reduction order entered by the Commission in a section 4(e) proceeding prior to determination of all of the issues therein. In support of the Commission's order, the Court said:

To do otherwise would have permitted Tennessee Gas to collect the *illegal* rate for an additional 18 months. . . . True, the exaction would have been subject to refund, but experience has shown this to be somewhat illusory in view of the trickling down process necessary to be followed, the incidental cost of which is often borne by the consumer, and in view of the transient nature of our society which often prevents refunds from reaching those to whom they are due.⁴⁷³ (Emphasis added; footnote omitted.)

⁴⁶⁹ *Id.* at 250.

⁴⁷⁰ *FPC v. Texaco, Inc.*, 377 U.S. 33 (1964), discussed in text accompanying notes 528-531 *infra*.

⁴⁷¹ *Atlantic Ref. Co. v. Pub. Serv. Comm'n*, 360 U.S. 378 (1959).

⁴⁷² *FPC v. Tennessee Gas Transmission Co.*, 371 U.S. 145 (1962).

⁴⁷³ *Id.* at 154.

Contrary to the Commission's position, the moratorium in question is in direct conflict with the *CATCO* decision, which the Commission says requires that such action be taken. In *CATCO*, the Court said:

The gas operator . . . is not without remedy to protect himself. *He may, unless otherwise bound by contract, . . . file new rate schedules with the Commission.* This rate becomes effective upon its filing, subject to the 5-month suspension provision of [section] 4 and the posting of a bond, where required. *This not only gives the natural gas company opportunity to increase its rates where justified but likewise guarantees that the consumer may recover refunds for moneys paid under excessive increases.*⁴⁷⁴ (Emphasis added.)

In granting . . . conditional certificates, the Commission does not determine initial prices nor does it overturn those agreed upon by the parties. Rather, it so conditions the certificate that the consuming public may be protected *while the justness and reasonableness of the price fixed by the parties is being determined under other sections of the Act.*⁴⁷⁵ (Emphasis added.)

These statements make it quite clear that in holding that the Commission may attach appropriate rate conditions in certificate cases, the Court assumed that gas producers would remain free to file rate increases up to contractually authorized levels, even if initial rate conditions were imposed. The Court was concerned by the fact that section 5⁴⁷⁶ cases were lengthy and did not provide the public with interim refund protection. The adequacy of the refund device to protect the public in section 4(e) proceedings was implicitly recognized. Recognition also was accorded the need to protect the interests of gas producers. The Court seems to have had in mind a procedure in certificate cases which would accommodate the interests of both producers and consumers. The imposition by the Commission of a condition requiring the reduction of an initial rate to a level found by the Commission to be "in the public interest" may be said to be consistent with this purpose if coupled with freedom on the part of the producer to file increases to contractually authorized levels. However, the imposition of such a condition is contrary to this purpose if coupled with a moratorium on the filing by producers of rate increases because the combination deprives producers of any protection without providing the public any substantial additional protection. Of course, any other rate increases which are "triggered" by a producer's collection of his full contract price are also subject to the suspension and refund provisions of section 4(e).

⁴⁷⁴ *Atlantic Ref. Co. v. Public Serv. Comm'n*, 360 U.S. 378, 389 (1959).

⁴⁷⁵ *Id.* at 392.

⁴⁷⁶ 52 Stat. 823 (1938), 15 U.S.C. § 717d (1958).

The producers' right to file increases to contractually prescribed levels even though initial rate conditions have been attached has been specifically recognized in several judicial decisions in which the moratorium was not in issue.⁴⁷⁷ In one case,⁴⁷⁸ the court upheld the Commission's imposition of initial rate conditions, but in so doing stated: "[W]e think it appropriate to say that we find no authority for holding that a producer does not have the right immediately to file a proposed rate increase of 20 cents per Mcf after complying with the condition that it file a new schedule carrying an initial price of 17.7 cents in lieu of the 20-cent rate in the contract."⁴⁷⁹ In another case,⁴⁸⁰ the court suggested that "in setting an initial rate," the Commission "should err on the low side *because the Company, under section 4, can immediately increase the rate*, subject to disallowance by the Commission after a full rate proceeding, the public being protected with reference to refunds in the interim."⁴⁸¹

In any event, the argument that rate increases should be banned because the obligation to refund does not adequately protect the public is not convincing. Under the scheme of regulation established by the act, not only refunds but also rate increases and decreases by producers must "trickle down" to ultimate consumers; none of these matters can affect consumers until *both* interstate pipelines and local distributors have taken action on the basis thereof. Just as the existing rates of a pipeline or distributor in a particular case may be sufficiently high to permit it to absorb an increase in the price it pays for gas, so may such rates be sufficiently low that it may be justified in retaining for itself, wholly or partially, the benefits of a decrease in the cost of purchased gas or a refund of past overcharges. However, in the long run, under any system of rate regulation in which regulated companies are permitted to recover their costs of service, the consuming public at large inevitably must be affected by any increase or decrease in such companies' costs. Any refund by a producer not passed along by the pipeline or distributor for any reason will offset a part of the cost of service of the pipeline or distributor and will affect ultimate consumers at large⁴⁸² in the form of either (1) a reduction in rates, (2) a delay in a rate increase, or (3) a reduction in the amount of a rate increase.

The most that any system of rate regulation can hope to achieve

⁴⁷⁷ *Atlantic Ref. Co. v. FPC*, 316 F.2d 677 (D.C. Cir. 1963); *California Oil Co. v. FPC*, 315 F.2d 652 (10th Cir. 1963); *Texaco, Inc. v. FPC*, 290 F.2d 149 (5th Cir. 1961).

⁴⁷⁸ *Texaco, Inc. v. FPC*, *supra* note 477.

⁴⁷⁹ *Id.* at 156.

⁴⁸⁰ *Atlantic Ref. Co. v. FPC*, 316 F.2d 677 (D.C. Cir. 1963).

⁴⁸¹ *Id.* at 679. (Emphasis added.)

⁴⁸² See *FPC v. Interstate Natural Gas Co.*, 336 U.S. 577, 581 (1948).

is protection of the public at large, for it would be impossible to insure absolute equity with respect to each individual consumer. Further, because the regulation of local distributors is beyond the jurisdiction of the Commission,⁴⁸³ the problem of adjusting equities between local distributors and individual consumers is not a proper matter of concern to the Commission, but must be resolved by state regulatory agencies.⁴⁸⁴

It may be conceded that the procedure of allowing increases to be filed by producers and placed into effect subject to an obligation to refund does not afford *perfect* protection to the public. It is also true, however, that this system does not perfectly protect producers either because any increase, regardless of its merit, may be suspended for five months. Certainly it is more reasonable to adopt a procedure which affords substantial protection to both consumer and producer than it is to follow one which gives complete protection to the interests of the former, while giving none to those of the latter. Furthermore, regardless of the merits of the procedure in question, it is, after all, the procedure prescribed by law and should not be repealed judicially or administratively.

The Supreme Court's recent decision in the *Hunt* case,⁴⁸⁵ which upheld the validity of a condition prohibiting rate increases during the pendency of a temporary certificate, does not support the validity of the moratorium in question. On the contrary, the Court in *Hunt* carefully limited the scope of its holding to temporary certificates and gave weight in reaching its decision to the difference which it perceived between temporary and permanent certification procedures. It was indicated that because temporary certificates were issued *ex parte*, the Commission should be given greater latitude in conditioning such certificates than in conditioning permanent certificates.⁴⁸⁶ The Court concluded that the Commission's powers under section 4 of the act are not operative until after a sale has been authorized by the Commission under a *permanent* or an *unconditioned temporary* certificate. "Under the procedures of the act, it is at the point of permanent or unconditional temporary certification that the provisions of section 4 become applicable. *The gas has been permanently certificated into interstate commerce and the independent producer is then free to pursue the rate filing procedure of that section.*"⁴⁸⁷

⁴⁸³ Section 1 of the act, 52 Stat. 821 (1938), as amended, 15 U.S.C. § 717(b) (1958).

⁴⁸⁴ See *FPC v. Interstate Natural Gas Co.*, 336 U.S. 577, 593-95 (1948) (concurring opinion).

⁴⁸⁵ *FPC v. Hunt*, 376 U.S. 515 (1964), discussed in text accompanying notes 635-639 *infra*.

⁴⁸⁶ *Id.* at 523.

⁴⁸⁷ *Ibid.* (Emphasis added.)

Although it must be admitted that some of the reasoning in *Hunt* could be applied to permanent as well as to temporary certification procedures, it is difficult to imagine how such an extension of the *Hunt* rationale could be squared with *CATCO*. Indeed, in *Hunt* the Court quoted with approval⁴⁸⁸ a part of *CATCO*⁴⁸⁹ which supported the continuing vitality of section 4 procedures after Commission imposition of an initial rate condition.

In a recent case,⁴⁹⁰ the Fifth Circuit held that the Commission was without authority to impose a moratorium on rate increases as a condition to permanent certification. The court's opinion on this point was in substantial agreement with the views set out above.

c. Effect of Area Rate Determinations

In 1960, the Commission abandoned the individual company approach to the determination of just and reasonable producer rates and announced its intent to determine such rates on an area basis.⁴⁹¹ Since then it has instituted four area rate proceedings.⁴⁹² Assuming *arguendo* that the area approach is valid⁴⁹³ and that just and reasonable rates will be validly determined in pending and future area proceedings, the effect of these determinations on the rate issue in certificate cases deserves consideration.

The Supreme Court made it clear in *CATCO* that the introduction of the rate issue in certificate cases was only an interim device to be utilized to "hold the line" pending determination of the applicable just and reasonable rate.⁴⁹⁴ Thus, if a just and reasonable rate determined in an area proceeding were applicable to proposed new sales, the rate issue apparently would drop out of certificate proceedings; if it were not applicable, then it would seem that the rate issue and the considerations raised by *CATCO* would continue to be an issue in those proceedings. Will just and reasonable area rates automatically govern new sales? The Commission suggested an affirmative reply in the remanded *CATCO* case⁴⁹⁵ when it expressed the view that "the

⁴⁸⁸ *Id.* at 524.

⁴⁸⁹ *Atlantic Ref. Co. v. Public Serv. Comm'n*, 360 U.S. 378, 391-92 (1959).

⁴⁹⁰ *Callery Properties, Inc. v. FPC*, 335 F.2d 1004 (5th Cir. 1964), discussed in text accompanying and following notes 331-337 *supra*.

⁴⁹¹ *Phillips Petroleum Co.*, 24 F.P.C. 537, 13 O. & G.R. 343 (1960), *aff'd sub nom. Wisconsin v. FPC*, 303 F.2d 380 (D.C. Cir. 1961), *aff'd*, 373 U.S. 294 (1963).

⁴⁹² See note 256 *supra*.

⁴⁹³ Consideration of the validity of, and the regulatory problems inherent in, the area rate approach is beyond the scope of this Article. For treatment of these matters, see Orn, *FPC Excursion into New Regulatory Fields*, 14 Ann. Inst. on Oil and Gas Law and Taxation 71 (1963); Ross, *The Area Rate Proceedings: An Unsettled Experiment in Public Control of Natural Gas Prices*, 18 Sw. L.J. 165 (1964); Comment, *Legality of FPC Regulation of Independent Gas Producers by Area Price Fixing*, 50 Geo. L.J. 250 (1961).

⁴⁹⁴ *Atlantic Ref. Co. v. Public Serv. Comm'n*, 360 U.S. 378, 392 (1959).

⁴⁹⁵ *Continental Oil Co.*, 27 F.P.C. 96, 15 O. & G.R. 841 (1962), discussed in text accompanying notes 271-278 *supra*.

price problem" in certificate cases would be eliminated by the conclusion of area rate proceedings.⁴⁹⁶

It does not appear, however, that initial rates will be any less of a problem in certificate cases initiated *after* the determination of just and reasonable area rates than at present. The pending area rate proceedings are basically section 5(a) cases directed at *all* rates within each of the affected areas. Consolidated with the section 5(a) case in each proceeding are a number of pending section 4(e) rate increase cases. In the *Permian Basin* case,⁴⁹⁷ pending certificate applications also have been consolidated. The section 4 and section 7 proceedings may be ignored for purposes of this discussion because they are limited to specific sales. The basic question, therefore, concerns the scope of the determination in the pending area section 5(a) proceedings.

Desirable though it might seem to the Commission from the standpoint of administrative expedience, there simply is no basis in the act for applying a Commission determination of a just and reasonable area rate to any sale of gas not subject to the Commission's jurisdiction before the close of the hearing upon which such determination is based. Section 5(a) provides in pertinent part as follows:

Whenever the Commission, *after a hearing*, . . . shall find that any rate . . . charged . . . by any natural gas company in connection with any . . . sale of natural gas, subject to the jurisdiction of the Commission, . . . is unjust, unreasonable, unduly discriminatory, or preferential, the Commission shall determine the just and reasonable rate . . . to be thereafter observed and in force, and shall fix the same by order . . .⁴⁹⁸
(Emphasis added.)

Thus, it seems clear from the language of the act that a rate established by contract for a specific sale can be changed by the Commission pursuant to section 5(a) only upon a *finding* by the Commission following a hearing that the rate in question is unlawful.⁴⁹⁹ In this connection, the Supreme Court has said⁵⁰⁰ of the Commission's authority under section 206(a) of the Federal Power Act,⁵⁰¹ in all material respects identical to section 5(a) of the Natural Gas

⁴⁹⁶ *Id.* at 100, 15 O. & G.R. at 845.

⁴⁹⁷ 24 F.P.C. 1121 (1960).

⁴⁹⁸ 52 Stat. 823 (1938), 15 U.S.C. § 717d(a) (1958).

⁴⁹⁹ See *United Gas Pipe Line Co. v. Mobile Gas Serv. Corp.*, 350 U.S. 332 (1956); *FPC v. Sierra Pac. Power Co.*, 350 U.S. 348 (1956); *FPC v. Natural Gas Pipeline Co. of America*, 315 U.S. 575, 584-85 (1942); *Wichita R.R. & Light Co. v. Public Util. Comm'n.*, 260 U.S. 48 (1922); *Michigan Consol. Gas Co. v. Panhandle Eastern Pipe Line Co.*, 226 F.2d 60 (6th Cir. 1955), *cert. denied*, 350 U.S. 987 (1956); *Colorado Interstate Gas Co. v. FPC*, 142 F.2d 943, 954 (10th Cir. 1944).

⁵⁰⁰ *FPC v. Sierra Pac. Power Co.*, *supra* note 499.

⁵⁰¹ 49 Stat. 852 (1920), 16 U.S.C. § 824e (1958).

Act, that "*the condition precedent to the Commission's exercise of its power . . . is a finding that the existing rate is 'unjust, unreasonable, unduly discriminatory, or preferential.'*"⁵⁰²

The requirement that a hearing be held and a finding be made by the Commission with respect to a specific rate and sale compels the conclusion that a determination of a just and reasonable rate in a section 5(a) case cannot be applicable to any sale which becomes subject to the Commission's jurisdiction *after* the close of the hearing in such case.⁵⁰³ Because the mere execution of a gas sales contract and the application for a certificate to make sales pursuant thereto does not bring a sale within the ambit of the Commission's regulatory authority,⁵⁰⁴ it would appear that a sale of gas for resale in interstate commerce must actually have been *made* (i.e., deliveries must have begun) pursuant to Commission authority, prior to the completion of a section 5(a) hearing, if the resultant order is to be applicable thereto.

Of course, the scope of a Commission order in a section 5(a) case may be narrower than the maximum permitted by the act. Within statutory limits, the scope of the order emanating from the pending area proceedings will depend upon which sales have been made subject to the proceeding by the Commission upon appropriate procedural steps. In the *Permian Basin*⁵⁰⁵ and *south Louisiana*⁵⁰⁶ proceedings, the orders initiating the proceedings seem to contemplate that only sales being made at the time the orders were issued are covered. However, the order instituting the latest two proceedings is couched in broader terms.⁵⁰⁷

⁵⁰² FPC v. Sierra Pac. Power Co., 350 U.S. 348, 353 (1956). (Emphasis added.)

⁵⁰³ Even with respect to those sales to which a Commission determination of just and reasonable rates is applicable, the rates so determined are not binding for all time. Upon the determination and effectuation of just and reasonable rates, any producer making a sale affected thereby will be free, under § 4 of the act, to file a rate increase to the level permitted by contract for such sale. Upon making such a filing, a producer must be given an opportunity to support the justness and reasonableness of the changed rate—i.e., the Commission's area determinations will *not* provide a basis for summary disallowance of future rate increases *above* the just and reasonable area rate so determined. See United Gas Pipe Line Co. v. Memphis Light, Gas & Water Div., 358 U.S. 103 (1958); Pennsylvania Water & Power Co. v. FPC, 343 U.S. 414, 423-24 (1952); FPC v. Hope Natural Gas Co., 320 U.S. 591, 615 (1944); Willmut Gas & Oil Co. v. FPC, 294 F.2d 245 (D.C. Cir. 1961), *cert. denied*, 368 U.S. 975 (1962); Mississippi River Fuel Corp. v. FPC, 202 F.2d 899 (3d Cir. 1953), *appeal dismissed*, 345 U.S. 988 (1953); Panhandle Eastern Pipe Line Co. v. FPC, 143 F.2d 488, 498 (8th Cir. 1944); United Carbon Co., 19 F.P.C. 242, 249 (1958); Colorado Interstate Gas Co., 19 F.P.C. 1012, 1016 (1958). *But cf.* Panhandle Eastern Pipe Line Co. v. FPC, 236 F.2d 606 (3d Cir. 1956); Panhandle Eastern Pipe Line Co. v. FPC, 232 F.2d 467 (3d Cir. 1956), *cert. denied*, 352 U.S. 891 (1956); State Corp. Comm'n v. FPC, 206 F.2d 690, 716 (8th Cir. 1953), *cert. denied*, 346 U.S. 922 (1954).

⁵⁰⁴ Atlantic Ref. Co. v. Public Serv. Comm'n, 360 U.S. 378, 387 (1959); Pioneer Gathering Sys., Inc., 23 F.P.C. 260 (1960).

⁵⁰⁵ Area Rate Proceeding, 24 F.P.C. 1121 (1960).

⁵⁰⁶ Area Rate Proceeding, 25 F.P.C. 942 (1961).

⁵⁰⁷ Area Rate Proceeding, 30 F.P.C. 1354 (1963).

Thus, contrary to the Commission's apparent hopes, there is no reason to assume that the problem of initial rates will be solved by the completion of area rate proceedings. The same circumstances which moved the Supreme Court to introduce the rate issue into certificate cases in the first place still will be present. There will be no just and reasonable rate determination applicable to new sales and no way of making such a determination except through a new section 5(a) proceeding.

d. *A Proposal*

The initial rate issue was introduced into producer certificate proceedings because the fundamental issue in the regulation of producer gas sales—the method of determining just and reasonable rates—had not been resolved. Currently, ten years after the inception of producer regulation, the issue still is unresolved. The introduction of the rate issue into producer certificate cases was the Supreme Court's innovation, devised to fortify a weakness which the Court detected in the "bond" of consumer protection which it thought the act was designed to provide. Essentially, this weakness was the lack of consumer protection against possibly excessive rates during "nigh interminable" section 5(a) proceedings. It is reasonable to assume that if producer section 5(a) proceedings were expeditious instead of "nigh interminable," there would be no further reason for tampering with producer rates in certificate proceedings.

It now seems apparent, however, that Congressional action will be required to develop an expeditious method of determining just and reasonable producer rates.⁵⁰⁸ Having discarded in 1960 "the traditional original cost, prudent investment rate base method" in producer rates cases,⁵⁰⁹ the Commission's much-heralded area price approach to the problem now seems hopelessly bogged down after only four years.⁵¹⁰ The rate requirements of the act have defied rational application to producers. It should now be apparent to everyone—producers, consumers, pipelines, and Commissioners—that remedial legislation is essential. Such legislation either should exempt producer rates from regulation under the act or, alternatively, should provide

⁵⁰⁸ "There can be little doubt that the present Natural Gas Act no longer is an efficient regulatory instrument." Tarver, *The Natural Gas Regulatory Problem—A Middle Way*, ABA Proceedings, Section of Mineral & Natural Resource Law 15, 16 (1961).

⁵⁰⁹ *Phillips Petroleum Co.*, 24 F.P.C. 537, 13 O. & G.R. 343 (1960), *aff'd sub nom. Wisconsin v. FPC*, 303 F.2d 380 (D.C. Cir. 1961), *aff'd*, 373 U.S. 294 (1963).

⁵¹⁰ In the Permian Basin proceeding, the first area hearing instituted by the Commission, the examiner's decision was issued on September 17, 1964, three years and nine months after the proceeding was initiated. Commission and judicial review remain. In this connection, one court commented that "despite . . . the importation of resourceful new plans, . . . the fact is that progress is slow, so slow indeed that it is hardly progress." *Hunt v. FPC*, 306 F.2d 334, 343 (5th Cir. 1962), *rev'd on other grounds*, 376 U.S. 515 (1964).

a rational and expeditious mode of determining just and reasonable producer rates.

It would appear that the public interest would be served at least as well by exemption of producers as by enactment of a modified system of producer regulation.⁵¹¹ If this alternative were adopted, producer gas prices could be effectively regulated by critically scrutinizing the prices paid by interstate pipelines for gas supplies before allowing that cost to be included in their cost of service recoverable through rates to distributors and consumers. Notwithstanding the 1954 *Phillips* decision,⁵¹² it is conceded by nearly everyone familiar with the subject that the Natural Gas Act was written to apply not to producers, but to interstate pipelines,⁵¹³ which, being public utilities in the traditional sense, were appropriate subjects of regulation. As a general rule, *direct* control of the rates of those furnishing goods or services to public utilities has not been deemed essential to effective regulation of utility rates; but such rates have been controlled indirectly by permitting utilities to pass on to their customers only those costs incurred which are reasonable, thus placing the burden of unreasonable expenditures upon utility stockholders.⁵¹⁴

If strict proof were required from pipelines with respect to their gas purchase costs, and they were compelled to absorb any unjustified costs, it seems certain that the price paid for gas by pipelines would never exceed its worth. In fairness, the consuming public can ask for no more protection than this. Even if it be conceded that the *primary* purpose of the act was to protect consumers from "exploitation" at the hands of natural gas companies, there is nothing in the act or its legislative history which suggests that natural gas producers were to be "exploited" for the benefit of consumers. The word "ex-

⁵¹¹ In this connection, it should be noted that in its *Phillips* opinion the Commission stated that cost figures adduced in the many cases before it "show that natural gas has been, in almost all instances, substantially underpriced." *Phillips Petroleum Co.*, 24 F.P.C. 537, 546, 13 O. & G.R. 343, 353 (1960), *aff'd sub nom. Wisconsin v. FPC*, 303 F.2d 380 (D.C. Cir. 1961), *aff'd*, 373 U.S. 294 (1963). For a compelling argument in support of abolishing federal control of the price of gas at the wellhead, see Munn, *The Lesson of the Independent Gas Producer Regulatory Experiment*, ABA Proceedings, Section of Mineral & Natural Resource Law 17 (1961).

⁵¹² *Phillips Petroleum Co. v. Wisconsin*, 347 U.S. 672 (1954).

⁵¹³ As recently as 1961, the then general counsel of the Commission said: "Unquestionably, the Natural Gas Act was tailored to fit the pipelines, not the producers." Mason, *Problems in Regulation under Natural Gas Act of Interstate Operations of Producers*, ABA Proceedings, Section of Mineral & Natural Resource Law 30, 31 (1961). See also Orn, *FPC Excursion into New Regulatory Fields*, 14 Ann. Inst. on Oil and Gas Law and Taxation 71-72 (1963).

⁵¹⁴ See, e.g., *Mississippi River Fuel Corp. v. FPC*, 252 F.2d 619, 622 (D.C. Cir. 1957), *cert. denied*, 355 U.S. 904 (1957); *Pacific Tel. & Tel. Co. v. Public Utilities Comm'n*, 34 Cal. 2d 822, 215 P.2d 441 (1950); *Ohio Mining Co. v. Public Util. Comm'n*, 106 Ohio 138, 140 N.E. 143 (1922); *Humble Oil & Ref. Co. v. Railroad Comm'n*, 133 Tex. 330, 128 S.W.2d 9 (1939). See also Welch, *Public Utility Regulation* 431-33 (1961). *But cf.* *Mississippi River Fuel Corp. v. FPC*, 163 F.2d 433, 437 (D.C. Cir. 1947).

exploit" as used by the courts means "to take advantage of," which suggests (1) inequality of bargaining positions and (2) unfair action predicated thereon. Of course, producers of gas for the interstate market do not negotiate directly with consumers, so neither can directly "exploit" the other. If there were direct negotiation, producers and consumers would find themselves in roughly equal bargaining positions; the consumers' investment in gas burning equipment and need for energy to operate it would be balanced by the producers' investment in wells and leases and the need to sell gas in order to avoid (1) possible loss of their leases, (2) drainage, (3) waste through flaring gas produced in association with oil, and (4) liability for shut-in payments to their lessors. In other words, the price at the point of production that would result from direct negotiation would be the fair market value of the gas, and neither party could be said to have been "exploited." The effect of the suggested procedure would be to put consumers in the same position (to the extent of the Commission's power to do so) under the indirect relationship which exists between consumers and producers as they would be in if they dealt directly with producers; *i.e.*, they would be assured a rate based upon the fair market value of the gas at the point of production.

Consumers are no more entitled to rates which reflect an under-the-market price for purchased gas than they are to rates which reflect less than the market price for pipe, for pipe laying, or for any of the other commodities and services included in a pipeline's cost of service. Why then are not the suppliers and layers of pipe for use in an interstate pipeline subject to federal rate regulation? Certainly such regulation can no longer be thought inhibited by constitutional restrictions. Such regulation does not exist simply because it would not make any sense. Prices for supplying or laying pipe are effectively kept near cost (or sometimes below) by that sure and stringent regulator, competition. Further, such prices are *indirectly* regulated by the Federal Power Commission through the test of reasonableness discussed above.

When one views the ponderous administrative machinery and the formidable array of law which have evolved in the effort, unsuccessful to date, to regulate *directly* the price of gas sold to interstate pipelines, it seems inconceivable that *direct* regulation was really what Congress had in mind when it passed the Natural Gas Act. If *indirect* regulation were utilized, the Commission once again would have only a few regulated entities⁵¹⁵ with which to cope rather than the sev-

⁵¹⁵ The Commission has reported that at the end of 1962 there were only 40 "natural gas pipeline companies" in operation, "natural gas pipeline companies" being defined as "companies having transmission line mileage in excess of 250 miles and sales for resale in excess of 50 percent of total sales." FPC, Statistics of Natural Gas Companies 1962, at VII.

eral thousand⁵¹⁶ with which it now must deal. Its regulatory burden thus lightened, the Commission could regulate more effectively pipeline rates which, after all, have a more direct and immediate impact on the consuming public than do producer rates. Inherent in improved pipeline regulation would be effective *indirect* regulation of producer prices through the method previously described.

However, if *direct* regulation of producers is to be retained, the act should be amended to provide specifically that the just and reasonable rate for gas at the point of production shall be its fair market value.⁵¹⁷ The adoption of such a standard would provide consumers with all the protection they reasonably can expect; it would *not* be, as others have suggested,⁵¹⁸ tantamount to *no regulation*. Consumers would be assured that the rates they paid for gas would not include an artificially inflated price at the point of production resulting from collusion or lack of arm's-length bargaining. In other words, the act as so amended would protect consumers from "exploitation" at the hands of producers.

B. Condition Precedent To Certificate Application

In 1962, the Commission amended⁵¹⁹ its regulations to provide that certificate applications filed by producers would be rejected if the sales contracts submitted in support of the applications contained any price-changing provisions other than those defined by the Commission as permissible.⁵²⁰ Price-changing provisions defined as "permissible" by the Commission are: (1) provisions for reimbursement of state production taxes by the buyer to the seller; (2) provisions for a price change to a specific amount on a definite date; and (3) provisions that once in five-year periods of the contract during which no specific change is provided, the price shall be redetermined on the

⁵¹⁶ During 1962, domestically produced gas was supplied by some 1,300 producers having annual sales of 100,000 Mcf or more each, and by an estimated 3,200 additional producers with smaller sales. FPC, Sales by Producers of Natural Gas to Natural Gas Pipeline Companies 1962, at V.

⁵¹⁷ One pipeline attorney has publicly advocated that the just and reasonable rate for gas at the point of production be defined by statute as "the reasonable market price of the gas." Tarver, *The Natural Gas Regulatory Problem—A Middle Way*, ABA Proceedings, Section of Mineral & Natural Resource Law 15, 16 (1961). For a persuasive argument supporting "the fair market value" of gas as a proper measure of just and reasonable producer rates, see Smith, *The Operator Who Has Discovered a Gas Pool—What Next?*, 7 Rocky Mt. Min. Law Inst. 79, 98 (1962). Under the act as now written, just and reasonable producer rates cannot be determined solely by reference to field prices. *Bel Oil Corp. v. FPC*, 255 F.2d 548 (5th Cir. 1958), *cert. denied*, 358 U.S. 804 (1958).

⁵¹⁸ See, e.g., Johnson, *Producer Rate Regulation in Natural Gas Certification Proceedings: CATCO in Context*, 62 Colum. L. Rev. 773, 800 (1962).

⁵¹⁹ 27 Fed. Reg. 1356 (1962).

⁵²⁰ 18 C.F.R. § 157.25 (1961). For a detailed discussion of this amendment and related amendments, see Fitzgerald, *Adoption of Federal Power Commission Price-Changing Rules Without Evidentiary Hearing: Statutory Collision*, 18 Sw. L.J. 236 (1964).

basis of (and not higher than) rates subject to Commission jurisdiction which are not in issue in suspension or certificate proceedings, and which are in the area of the price in question.⁵²¹ Eliminated as not "permissible" were "favored nation" provisions, providing that a producer shall receive a price as high as any other price paid by his purchaser ("first party favored nation") or any price paid by any other purchaser ("second party favored nation") to any producer within a specified area, and "spiral escalation" provisions, providing that a producer shall be permitted to collect a higher price when his purchaser is permitted to collect a higher price. The reasons given by the Commission for outlawing these provisions were: (1) they are "by their nature and in their effects inherently unreasonable" because there "need be no economic or other substantial justification" for an increase pursuant thereto; (2) such provisions have a widespread impact; and (3) the administrative burden of processing increases filed pursuant to such provisions would be eliminated.⁵²²

This Commission-imposed condition precedent to the filing of certificate applications by producers has received judicial attention in several recent cases. Rejection of a certificate application for failure to meet this condition was held invalid by the Tenth Circuit.⁵²³ The Commission's action was referred to as a "bootstrap operation" which had the practical effect of circumventing the basic question of the propriety of indefinite pricing clauses. The Commission's rule-making authority was held not to encompass the power to promulgate the regulation relied on. The critical deficiency which the court found in the Commission's action was its failure to conduct an adversary hearing to determine whether these contract provisions were unlawful before prohibiting them by regulation. In this connection the court said: "Sections 4 and 5 . . . give the Commission power to modify contracts—not to make contracts. The power to modify can only be exercised after hearing. The controlling standard is what is just and reasonable."⁵²⁴ "No claim of administrative need or of frustration in the performance of its duties can make up for the lack of statutory authority."⁵²⁵ Although the court specifically invalidated only the order of rejection before it, it expressed the opinion that the basic order promulgating the condition to certification was void.

The Ninth Circuit, on the other hand, in holding that the Commission's rejection of a producer application upon the basis of the

⁵²¹ 18 C.F.R. § 154.93 (1961).

⁵²² *Pure Oil Co.*, 25 F.P.C. 383, 388-91, 15 O. & G.R. 369, 376-80 (1961), *aff'd*, 299 F.2d 370 (7th Cir. 1962).

⁵²³ *Texaco, Inc. v. FPC*, 317 F.2d 796 (10th Cir. 1963), *rev'd*, 377 U.S. 33 (1964).

⁵²⁴ *Id.* at 805.

⁵²⁵ *Id.* at 807.

condition was proper, stated that promulgation of the regulation was a valid exercise of the Commission's rule-making power.⁵²⁶ The court held that the challenged rule was not adjudicatory in nature and, therefore, that no hearing was required prior to its issuance. Further, the court placed some reliance on the fact that, pursuant to a general regulation of the Commission,⁵²⁷ any producer filing an application based on a contract containing any of the proscribed provisions could obtain a hearing by requesting a waiver of the rule.

The Supreme Court decided the issue in the same manner as had the Ninth Circuit.⁵²⁸ The Court held that the requirement in section 7⁵²⁹ that a hearing be held did not "preclude the Commission from particularizing statutory standards through the rule-making process and barring at the threshold those who neither measure up to them nor show reasons why in the public interest the rule should be waived."⁵³⁰ The Court agreed with the Ninth Circuit that the Commission's action in this case was not an "adjudication" and, hence, that an adversary hearing was not required precedent thereto. The Commission's rule was said not to pass on the merits of any rate structure or of a certificate of public convenience and necessity, but to prescribe "qualifications for applicants." Further, the Court saw no purpose in prolonging and crippling the processes of regulation by requiring the Commission to implement its policy against indefinite pricing clauses on a case-by-case basis. Also mentioned was the right to apply for a waiver of the rule in individual cases. Although the merits of the provisions which the Commission had outlawed were not before it, nevertheless the Court referred to the provisions as "a built-in device for ready manipulation of rates upward."⁵³¹

The Supreme Court's affirmance of the regulation in question is one of the latest in a series of decisions by the Court giving the Commission virtually free rein with respect to gas producers. Without reiterating them here, it is enough to observe that the criticisms previously made with respect to the moratorium on rate increases imposed by the Commission⁵³² are equally applicable to the regulation under discussion. The question of whether Commission policies may be applied through rule-making processes or must be applied on a case-by-case basis, to which the Supreme Court gave great attention, seems

⁵²⁶ *Superior Oil Co. v. FPC*, 322 F.2d 601 (9th Cir. 1963), *cert. denied*, 377 U.S. 922 (1964).

⁵²⁷ 18 C.F.R. § 1.7(b) (Supp. 1964).

⁵²⁸ *FPC v. Texaco, Inc.*, 377 U.S. 33 (1964).

⁵²⁹ 52 Stat. 824 (1938), as amended, 15 U.S.C. § 717f (1958).

⁵³⁰ 377 U.S. at 39.

⁵³¹ *Id.* at 42.

⁵³² Discussed in text accompanying notes 460-490 *supra*.

entirely beside the point. The relevant point is that the outlawing of contract provisions permitting increased gas prices is not a proper function of the Commission *in any kind of proceeding*.

As the Supreme Court has recognized,⁵³³ there is an obvious and long-observed distinction between "the service in which the producer engages" and "the contract which regulates his relationship with the transmission company in performing the service."⁵³⁴ The Commission's authority properly relates to the "service" performed by a producer rather than to the relationship established by contract between the producer and the pipeline. The Commission's regulatory concern begins only when the parties to a gas sales contract seek to make its provisions operative. At this point, the Commission must measure the contractually prescribed action against the standards of the act, and may take such measures as the act authorizes. Thus, when a producer files a rate increase authorized by the contract between the producer and the pipeline, the Commission may review the lawfulness of the new rate,⁵³⁵ but not the lawfulness of the provision which authorized the increase. The Commission's only concern with respect to the contract is to determine the "threshold question" of whether the increased rate actually is authorized by the sales contract.⁵³⁶

The Court's observation that the regulation in question does not pass on the *merits* of any rate structure or certificate application⁵³⁷ suggests the very reason why it is invalid. It is precisely the function of the Commission to pass on the *merits* of new rates and certificate applications filed, not to prohibit the *filing* of such matters for reasons having no relationship to their merits. To define the elements of a showing that a specific rate is just and reasonable may be said to be the "particularization" of statutory standards,⁵³⁸ but to bar producers from even making sales because the basic contract contains certain provisions for increasing prices is more akin to *amendment* of the act than to "particularization" of its standards.

The Commission's statement that the prohibited pricing clauses are "by their nature and their effects inherently unreasonable" seems untenable.⁵³⁹ That, as between the parties, there need be no "economic

⁵³³ *Sunray Mid-Continent Oil Co. v. FPC*, 364 U.S. 137 (1960).

⁵³⁴ *Id.* at 153.

⁵³⁵ *United Gas Pipe Line Co. v. Memphis Light, Gas & Water Div.*, 358 U.S. 103 (1958).

⁵³⁶ See *Texas Gas Transmission Corp. v. Shell Oil Co.*, 363 U.S. 263 (1960); *Pure Oil Co. v. FPC*, 299 F.2d 370 (7th Cir. 1962).

⁵³⁷ *FPC v. Texaco, Inc.*, 377 U.S. 33, 42 (1964).

⁵³⁸ The Commission has recently been judicially rebuffed for failing to so "particularize" the "just and reasonable" standard as applied to producer rates. *Hill v. FPC*, 355 F.2d 355 (5th Cir. 1964).

⁵³⁹ *Pure Oil Co.*, 25 F.P.C. 383, 389 (1961).

or other substantial justification" for a price increase under the clauses in question does not distinguish these provisions from the definite pricing clauses which the Commission recognizes as effective. With respect to the requirements of the act, *all* rate increases must be justified regardless of the nature of the contract provisions authorizing them. But under the act, rate increases are to be justified *after* they are filed, not before. At the time of certificate application, the factors which may justify a rate increase during the term of a contract are unknown. It is exactly this uncertainty that gave birth to the indefinite pricing provisions in question which are triggered by future events suggesting that a price increase is in order and may be justifiable before the Commission. To ban such provisions at the outset of a proposed sale seems in itself an act which is "inherently unreasonable."

C. Duration Of Permanent Certificates

Contrary to the impression conveyed by the word, a "certificate" of public convenience and necessity is not a specific, identifiable document that can be mounted and framed or filed away. Instead, it is a part of the order of the Commission finding that a gas sale is required by public convenience and necessity and authorizing deliveries to commence, or to continue if already commenced. In general, the certificate is effective on the date of the order issuing it or upon the satisfaction of any conditions imposed by the Commission. A producer who applies for and receives a certificate, conditioned or unconditioned, has no obligation under the act to accept the certificate,⁵⁴⁰ although the obligations imposed by his gas sales contract may inhibit rejection of a certificate issued exactly as applied for.⁵⁴¹ Nor does acceptance of a proffered certificate impose any obligations under the act upon the accepting producer.⁵⁴² It is only when gas deliveries are actually initiated by a producer pursuant to certificate authority that the producer incurs obligations under the act.⁵⁴³ One important obligation incurred is the duty to continue the deliveries so initiated.⁵⁴⁴ Because this obligation has always been considered to endure for the same period of time as the certificate under which deliveries

⁵⁴⁰ *Atlantic Ref. Co. v. FPC*, 360 U.S. 378, 387-88 (1959); *Sunray Mid-Continent Oil Co.*, 20 F.P.C. 730, 732 (1958).

⁵⁴¹ See *Gulf Oil Corp. v. American Louisiana Pipe Line Co.*, 282 F.2d 401 (6th Cir. 1960).

⁵⁴² *Pioneer Gathering Sys., Inc.*, 23 F.P.C. 260 (1960). See also *FPC v. Panhandle Eastern Pipeline Co.*, 337 U.S. 498 (1949).

⁵⁴³ *Atlantic Ref. Co. v. Public Serv. Comm'n*, 360 U.S. 378, 387 (1959); *Sunray DX Oil Co.*, 29 F.P.C. 1295 (1963); *Pioneer Gathering Sys., Inc.*, *supra* note 542, at 263.

⁵⁴⁴ *Atlantic Ref. Co. v. Public Serv. Comm'n*, *supra* note 543, at 389; *Harper Oil Co. v. FPC*, 284 F.2d 137, 139 (10th Cir. 1960). Cf. *J. M. Huber Corp. v. FPC*, 236 F.2d 550 (3d Cir. 1956), *cert. denied*, 352 U.S. 971 (1957).

were initiated,⁵⁴⁵ the duration of certificates became an issue early in the history of Commission regulation of producers. Producers took the position that they were entitled to certificates limited in duration to the term of their gas sales contracts, and that certificates issued without a term limitation were, ipso facto, coterminous with the related gas sales contracts.

Initially, the Commission took the position that it was without authority to issue limited term certificates.⁵⁴⁶ The Tenth Circuit, however, held the Commission's position to be erroneous.⁵⁴⁷ The court held that the Commission was authorized, under its section 7(e) conditioning power, to grant certificates of public convenience and necessity of limited duration, and that section 7(b),⁵⁴⁸ requiring Commission approval prior to abandonment of service, did not restrict the Commission's authority to issue limited term certificates. On the other hand, the court ruled that the Commission was not *required* to issue limited term certificates when requested. The Tenth Circuit's ruling on this point, after some procedural circularity, was confirmed by a divided Supreme Court in *Sunray Mid-Continent Oil Co. v. FPC*.⁵⁴⁹

The majority of the Court adopted what can only be called a strained reading of sections 7(c) and 7(e) of the act in order to reach a result which it obviously deemed desirable. It stated that a contrary holding would permit gas producers, upon the expiration of their gas sales contracts, (1) to terminate deliveries of gas without obtaining authority from the Commission pursuant to section 7(b) of the act, (2) to enter into new contracts at higher rates without being subject to the rate-changing provisions of sections 4(d) and

⁵⁴⁵ See discussion with respect to temporary certificates in text accompanying notes 658-685 *infra*. This view was judicially expressed as early as 1956. *Sunray Mid-Continent Oil Co. v. FPC*, 239 F.2d 97 (10th Cir. 1956), *rev'd on other grounds*, 353 U.S. 944 (1957). See Atkinson, *Federal Regulation of Natural Gas—The Independent Producers' Status*, 13 Sw. L.J. 425, 457 (1959).

⁵⁴⁶ *Sunray Mid-Continent Oil Co.*, Nos. 8826, 8907, and 9403, FPC, July 25, 1955, and January 4, 1956.

⁵⁴⁷ *Sunray Mid-Continent Oil Co.*, 239 F.2d 97 (10th Cir. 1956), *rev'd on other grounds*, 353 U.S. 944 (1957).

⁵⁴⁸ 52 Stat. 824 (1938), as amended, 15 U.S.C. § 717f(b) (1958). Section 7(b) provides as follows:

No natural-gas company shall abandon all or any portion of its facilities subject to the jurisdiction of the Commission, or any service rendered by means of such facilities, without the permission and approval of the Commission first had and obtained, after due hearing, and a finding by the Commission that the available supply of natural gas is depleted to the extent that the continuance of service is unwarranted, or that the present or future public convenience and necessity permit such abandonment.

This provision has been held applicable to producer sales. *E.g.*, *Hunt v. FPC*, 334 F.2d 474 (5th Cir. 1964); *J. M. Huber Corp. v. FPC*, 236 F.2d 550 (3d Cir. 1956), *cert. denied*, 352 U.S. 971 (1957).

⁵⁴⁹ 364 U.S. 137 (1960).

4(e) of the act, and (3) to obtain new certificates covering such contracts. In the latter circumstance, the majority observed that "the only power the Commission would have, under the Act, with respect to those rates, would be to bear the burden of proof in an investigation under section 5 of the Act, that the rates are unjust and unreasonable. . . ."⁵⁵⁰ The majority feared that the power to change rates coupled with the "leverage" of the power to abandon deliveries without Commission approval would seriously affect the "regulatory scheme," the "primary aim" of which was consumer protection.⁵⁵¹

Having explained the practical reasons for its decision, the majority came to grips with the language of the act. Section 7(e) of the act provides that if the requisite findings are made, a certificate shall be issued to the applicant "authorizing *the whole or any part* of the operation, sale, service, construction, extension, or acquisition covered by the application."⁵⁵² One of the requisite findings is "that the applicant is able and willing properly to do the acts and to perform the service proposed."⁵⁵³ Relying upon this language, the producer contended that the Commission had no power to authorize more than what the applicant proposed, *e.g.*, to tender a certificate unlimited in time to an applicant proposing a sale of gas for twenty years only.

The majority found this contention "unpersuasive," because it depended on "freighting" the phrase "the whole or any part" with a "load" of unwarranted negative meaning.⁵⁵⁴ The majority argued that the phrase could be interpreted to mean only that the certificate granted must be sufficient to authorize the specific sale proposed, and that an unlimited certificate would meet this requirement. Further, the majority took the position that a producer proposing a sale is also proposing a "service"—namely, the movement of gas in interstate commerce—which was said to be commenced by the initial sale. The majority concluded that because section 7(e) permits the Commission to authorize services as well as sales, it was not restricted to authorizing the specific sale proposed, but could go further and authorize the "service" which the proposed sale represented. The requisite "willingness" to perform the "service proposed" was found by the majority to be inferable from the

⁵⁵⁰ *Id.* at 144. Although the majority often referred to the CATCO opinion, written just a year earlier, it ignored the basic holding of that case, as shown in this quotation, that the Commission may exercise its conditioning power in certificate cases to reduce prices.

⁵⁵¹ *Id.* at 143, 147. In explaining the potential impact of the producer's contentions on the "regulatory scheme," the majority noted that such contentions would be equally applicable to pipelines. *Id.* at 143.

⁵⁵² 56 Stat. 84 (1942), 15 U.S.C. § 717f(e) (1958). (Emphasis added.)

⁵⁵³ *Ibid.*

⁵⁵⁴ *Sunray Mid-Continent Oil Co. v. FPC*, 364 U.S. 137, 148-49 (1960).

applicant's willingness to execute a long-term sales contract,⁵⁵⁵ a "specific manifestation" of such service. The majority noted and gave weight to the Commission's past practice of distinguishing between contracts and "underlying service."⁵⁵⁶

The majority rejected the contention that if the public interest requires unlimited term certificates, this end should be achieved by Commission rejection of all requests for limited term certificates or by the use of the Commission's conditioning power.⁵⁵⁷ The majority saw no purpose in resorting to such indirect methods and expressed fear that if the Commission's direct approach were invalidated, the indirect procedure likewise would be overturned on appeal. Also rejected by the majority was a contention that its decision would violate the integrity of private contracts. In this connection, it was noted that both parties to the gas sales contract would continue to be bound by it during its term and that the producer's obligation to continue deliveries after expiration of the contract would flow not from the contract but from the act.

Similarly dismissed was the producer's contention that it would be in a position of inequality after the expiration of the contract because it would continue to be obliged to deliver gas but the purchaser no longer would be obliged to take it. Deftly sidestepping the question whether an obligation to continue taking natural gas, corresponding to a producer's obligation to continue delivering, was imposed by the act upon a purchaser after expiration of the contract,⁵⁵⁸ the majority noted that the purchaser would continue to have obligations under the act to local distributors and that its need for a continuing gas supply to meet these obligations might enhance the producer's post-contract "bargaining strength."⁵⁵⁹ In other words, regardless of whether the purchaser was compelled by law to continue taking, it would be forced to do so by necessity.

In the companion case, *Sun Oil Co. v. FPC*,⁵⁶⁰ decided by the same majority, it was held that a certificate issued by the Commission without specific time limitations was of unlimited duration despite (1) the fact that the producer had applied for a certificate "authorizing

⁵⁵⁵ *Id.* at 151.

⁵⁵⁶ *Id.* at 152.

⁵⁵⁷ In this connection, the majority also sustained the Commission's imposition of the burden of proof on the producer to support a limited term certificate instead of taking upon itself the burden of justifying the issuance of a certificate unlimited in term. *Id.* at 157.

⁵⁵⁸ The Commission has since decided that such an obligation is imposed upon gas purchasers under the act. *Continental Oil Co., No. 426, FPC, May 5, 1964, rehearing denied, No. 426A, July 2, 1964, appeal docketed, No. 21693, 5th Cir., July 6, 1964.*

⁵⁵⁹ *Sunray Mid-Continent Oil Co. v. FPC*, 364 U.S. 137, 155 (1960).

⁵⁶⁰ 364 U.S. 170 (1960).

the sale of natural gas in the circumstances . . . described," having described these "circumstances" by incorporating the gas sales contract by reference,⁵⁶¹ and (2) the fact that the Commission had issued the certificate "authorizing the sale of natural gas . . . as more fully described in the application. . . ."⁵⁶² Upon the expiration of the original contract, the producer and pipeline had executed a new one providing for a considerably higher price, and the producer had applied for certificate authority covering the new sale. The Commission had rejected this application as duplicative of existing authority, and upon the filing of the new contract under protest as a rate increase, it suspended the operation of the new rate. The majority based its holding affirming the Commission upon the absence of any explicit time limitation in either the application for the original certificate or in the order issuing it. The majority also placed reliance upon the fact that at the time the original certificate was issued, the Commission was asserting the view, albeit erroneous, that it possessed no authority to issue limited term certificates.

Expressing what seems the better view, the four dissenters in *Sunray Mid-Continent*⁵⁶³ and *Sun*⁵⁶⁴ took the position that the Commission is powerless summarily to authorize more than is proposed by a producer.⁵⁶⁵ The majority was said to have ignored the "basic distinction between an interstate pipeline and an independent producer of natural gas,"⁵⁶⁶ namely, that a pipeline performs traditional public-utility "service," whereas an "independent producer is unique among the objects of public-utility regulation because it is not engaged in rendering a service to the public in the conventional sense of that concept, but rather simply in selling a commodity which it owns."⁵⁶⁷

The majority's "notion" that producers render a continuing service to the public in the same sense as pipelines or other conventional utilities was said to be its basic error. The dissenters concluded that the sole act which *Phillips*⁵⁶⁸ held subjected producers to Commission regulation was the sale of natural gas and that, as to independent producers, only a limited scheme of regulation was contemplated by the statute, viz., control over the prices and the other terms of sale of their natural gas.⁵⁶⁹ The word "sale," it was said, "signifies a

⁵⁶¹ *Id.* at 171.

⁵⁶² *Id.* at 172 n. 2.

⁵⁶³ 364 U.S. 137 (1960).

⁵⁶⁴ 364 U.S. 170 (1960).

⁵⁶⁵ *Sunray Mid-Continent Oil Co. v. FPC*, 364 U.S. 137, 159 (1960).

⁵⁶⁶ *Id.* at 160.

⁵⁶⁷ *Ibid.*

⁵⁶⁸ *Phillips Petroleum Co. v. Wisconsin*, 347 U.S. 672 (1954).

⁵⁶⁹ *Sunray Mid-Continent Oil Co. v. FPC*, 364 U.S. 137, 161 (1960).

transaction limited in duration and amount."⁵⁷⁰ From the fact that a producer is not required to "dedicate" his gas supply to the interstate market in the first instance, the dissenters reasoned that a producer should be free to propose the amount of gas he will so "dedicate."⁵⁷¹

The Commission was said to lack authority to require, under threat of outright denial of the application, acceptance of a certificate authorizing the sale of more gas than proposed without meeting the requirements of section 7(e) for the imposition of conditions on certificates. It was in the Commission's section 7(e) conditioning power that the dissenters found the answer to the practical difficulties which the majority feared would flow from denying the Commission the authority which it had asserted in this case. If a limited term certificate were deemed contrary to public interest by the Commission in a given case, the dissenters argued, a perpetual certificate could be issued under the Commission's section 7(e) conditioning power, but in such a case the Commission would have to bear the burden of showing that public convenience and necessity requires such a condition. The dissenters found nothing in the act equating a "sale" with a "service." On the contrary, the terms were found to be used disjunctively in the act at all times.⁵⁷²

Pursuing this line of reasoning, the dissenters concluded that the certificate in question in the *Sun* case⁵⁷³ should be held to be one of limited term. They interpreted the Commission's order issuing this certificate as authorizing the sale proposed, thereby limiting the term of the certificate to that of the sale. Further, they were of the opinion that the producer could not be bound by the Commission's erroneous views concerning the scope of its authority and that, absent a specific condition to the contrary, the Commission was authorized to issue only a limited term certificate. The majority was said to have strained the provisions of the Natural Gas Act beyond permissible limits in order to reach a result which it deemed more appropriate to effective regulation, and to have "taken impermissible liberties with statutory language in order to remedy what it considers an undesirable deficiency in the way Congress has written the statute."⁵⁷⁴

In the last analysis, however, the only essential difference between the majority and minority views in these two cases concerned the *method* by which the issuance of unlimited term certificates upon

⁵⁷⁰ *Id.* at 162.

⁵⁷¹ *Id.* at 163.

⁵⁷² *Id.* at 165.

⁵⁷³ *Sun Oil Co. v. FPC*, 364 U.S. 170 (1960).

⁵⁷⁴ *Sunray Mid-Continent Oil Co. v. FPC*, 360 U.S. 137, 169 (1960).

application for limited term certificates was to be achieved. Both agreed that the Commission could accomplish this result. The majority allowed it to be done summarily, without supporting findings; the minority would require such action to be supported by findings relating it to public convenience and necessity. The minority's approach seems preferable. In no other area of its jurisdiction is the Commission permitted to regulate arbitrarily. The reduction of a proposed initial rate "must be supported by soundly based findings in the record before the Commission."⁵⁷⁵ There appears to be no reason why Commission alteration of the proposed term of a sale should not be subject to the same requirements.

Therefore, under the holding in the *Sunray Mid-Continent* case, the duration of a certificate and the corresponding duty to continue deliveries initiated thereunder are not necessarily limited to the duration of the underlying sales contract; unless a limited term certificate is issued, both the certificate and the duty to deliver remain in force until Commission authority under section 7(b) of the act to abandon the sale is obtained. Under the *Sun* decision, a certificate will be deemed to be of limited duration only if the Commission specifically so provides; that a certificate is issued as applied for is not sufficient for this purpose. The burden is on a producer seeking a limited term certificate to prove that public convenience and necessity requires the issuance of the certificate. Because the burden of obtaining a limited term certificate is now virtually the same as that of obtaining abandonment authority, limited term certificates seldom are requested by producers.

D. Successors In Interest

Although there is no such provision in the act or in Commission regulations, each certificate issued by the Commission provides that it shall not be transferable and that it shall be effective only so long as the named producer continues the acts authorized in accordance with the provisions of the act.⁵⁷⁶ These certificate provisions have made it necessary to obtain Commission approval not only upon the initiation of a sale, but also upon its continuation by one to whom the certificate holder has assigned his interest in the gas-producing property. Authority for the successor in interest to continue the sale may be obtained through one of two procedures: (1) the original seller may seek authority to abandon the sale and the successor may apply for a new certificate, or (2) the successor in interest may request that the

⁵⁷⁵ *Pure Oil Co. v. FPC*, 292 F.2d 350, 352 (7th Cir. 1961).

⁵⁷⁶ *E.g.*, *Texaco, Inc.*, No. 4616, FPC, May 6, 1964; *Texaco Seaboard, Inc.*, 29 F.P.C. 593, 600, 17 O. & G.R. 874, 884 (1963).

Commission substitute it as holder of the certificate originally issued. The latter method is more commonly employed, and seems conceptually correct. When producing property is assigned, there is no abandonment of a sale and initiation of a new one; the original sale is continued without any change other than the identity of the seller.

In a recent case⁵⁷⁷ in which a successor in interest sought to be substituted as holder of the original certificate, it was contended that the initial rate issue should be reopened. The Commission rejected this contention by a divided vote and ruled that a successor in interest stood in the shoes of his predecessor. Hence, the successor was permitted to collect the last rate not subject to refund collected by his predecessor.

Noting that the only change between initial certification of a sale and application by a successor to be substituted as holder of the certificate is the identity of the seller, the Commission stated that the purpose of making certificates nontransferable was a narrow one, viz., to permit the Commission to "focus on the successor himself, to ensure that he is not, for some particular reason, unqualified to hold a certificate."⁵⁷⁸ This position was said to be supported by substantial public interest considerations and to be required by justice and equity. A contrary ruling, the Commission observed, would require a new inquiry into rates every time a producer holding a certificate died; might permit successors to charge as initial rates not subject to refund the same rates collected by their predecessors subject to refund; and would introduce additional rate uncertainty, inhibiting transfers of interests, "thus interfering with the normal functioning of the industry."⁵⁷⁹ The salutary effect upon consumer prices that might be accomplished by this disruptive practice was said to be minimal. Conceding that some of the sales in issue were originally certificated at prices higher than those currently being allowed, the Commission stated that it would not allow the prices permitted by the certificates issued successors in interest to be used to show the proper "price line" at any time. Succession proceedings were classified by the Commission as unique.⁵⁸⁰

⁵⁷⁷ *Graridge Corp.*, 30 F.P.C. 1156 (1963).

⁵⁷⁸ *Id.* at 1162.

⁵⁷⁹ *Id.* at 1163.

⁵⁸⁰ The Commission has refused to apply the rationale which it has adopted in succession cases to situations in which new acreage is substituted for that from which gas was previously sold pursuant to Commission certification; such substitution is treated as a new sale. *Superior Oil Co.*, No. 437, FPC, July 23, 1964.

III. TEMPORARY CERTIFICATES

A. *Why Needed*

In almost all cases, gas producers seeking certificates of public convenience and necessity hold oil and gas leases on the acreage from which the proposed gas sales are to be made. The terms of the leases often make gas production at the earliest possible date a matter of the utmost importance. A producer's entire investment may be at stake because his lease may expire absent actual gas production by a given date, or the absence of production on a given date may require the payment of substantial "shut-in gas royalties" to preserve the lease.⁵⁸¹ Because of the fugacious nature of gas in the reservoir, a producer and his lessor may suffer substantial and irreparable loss to lessees and owners of adjoining acreage each day the producer's wells are shut in due to lack of certificate authority. If the gas in question is produced in association with oil, it may be necessary to flare it pending issuance of a certificate by the Commission. Some urgency for the issuance of certificate authority also may be caused by the provisions in the gas sales contract making the issuance of acceptable certificate authority by a stated time a condition precedent to the effectiveness of the sale.⁵⁸²

Under any of these circumstances, procedures for obtaining permanent certificates may be too slow. A hearing is required by the act before a permanent certificate may be issued, even if the application is not contested. At best, the issuance of a permanent certificate may take several months; at worst, it may take several years. To cope with this situation, the Commission issues temporary certificates.⁵⁸³

B. *Commission Authority To Issue Temporary Certificates*

The only provision in the act specifically authorizing the Commission to issue temporary certificates is found in section 7(c): "The Commission may issue a temporary certificate in cases of emergency, to assure maintenance of adequate service or to serve particular customers . . . pending the determination of an application for a certificate. . . ."⁵⁸⁴ Temporary certification procedures applicable to producers are prescribed in detail by Commission regulation.⁵⁸⁵ Subject to

⁵⁸¹ See generally Maxwell, *Oil and Gas Lessee's Rights on Failure to Obtain Production During the Primary Term or to Maintain Production Thereafter*, 3 Rocky Mt. Min. Law Inst. 133, 184-93 (1957).

⁵⁸² See generally Richardson, *Producer Contracts for Sale of Natural Gas in Interstate Commerce*, 11 Ann. Inst. on Oil and Gas Law and Taxation 201, 215-16 (1960); Howell, *Natural Gas Purchase Contracts*, 5 Rocky Mt. Min. Law Inst. 221, 227-30 (1959).

⁵⁸³ During the Commission's fiscal year 1963, it issued 1516 temporary certificates to gas producers. 43 FPC Ann. Rep. 129 (1963).

⁵⁸⁴ 56 Stat. 84 (1942), 15 U.S.C. § 717f(c) (1958).

⁵⁸⁵ 18 C.F.R. § 157.28 (1961).

specified limitations and requirements, the regulation permits a producer who has filed an application for a certificate and a related rate schedule to "initiate" the sale "in the event of an emergency that does not involve immediate danger to life or property,"⁵⁸⁶ and to continue such sale pending final Commission action on the certificate application. The most important requirement specified is the filing of a statement by the producer of its intention to invoke the regulation, "setting forth the facts constituting the emergency requiring such action, which may include, *inter alia*, drainage, threatened loss of lease, flaring, economic hardship resulting from payment of shut-in royalties, or similar situations."⁵⁸⁷

Although the Commission has been issuing temporary certificates to gas producers pursuant to this regulation for several years, its validity was judicially tested for the first time only recently.⁵⁸⁸ The regulation was sustained by the court on the basis of section 16 of the act,⁵⁸⁹ which grants the Commission authority to make rules and regulations, rather than on the basis of the above-quoted provision of section 7(c),⁵⁹⁰ which, the court held, "has a special relationship to pipelines."⁵⁹¹ The court relied on the fact that the issuance of such certificates to independent producers had been tacitly accepted as valid in a number of prior cases. In these prior cases, although the point was not directly in issue, the Commission's authority to issue temporary certificates had been assumed to flow from section 7(c).⁵⁹² Further, in two cases subsequent to *Public Serv. Comm'n v. FPC*,⁵⁹³ the courts have treated section 7(c) as the source of the Commission's authority to issue temporary certificates.⁵⁹⁴

C. Commission's Authority To Impose Conditions On Temporary Certificates

Despite the absence of any specific authority in the act to impose conditions upon temporary certificates, it has been held uniformly that such authority is implicit in the Commission's authority to

⁵⁸⁶ *Ibid.*

⁵⁸⁷ *Ibid.*

⁵⁸⁸ *Public Serv. Comm'n v. FPC*, 327 F.2d 893 (D.C. Cir. 1964).

⁵⁸⁹ 52 Stat. 830 (1938), 15 U.S.C. § 717o (1958).

⁵⁹⁰ Quoted in text accompanying note 584 *supra*.

⁵⁹¹ *Public Serv. Comm'n v. FPC*, 327 F.2d 893, 896 (D.C. Cir. 1964).

⁵⁹² *Hunt v. FPC*, 306 F.2d 334 (5th Cir. 1962), *rev'd on other grounds*, 376 U.S. 515 (1964); *American Liberty Oil Co. v. FPC*, 301 F.2d 15 (5th Cir. 1962); *J. M. Huber Corp. v. FPC*, 294 F.2d 568 (3d Cir. 1961); *Pure Oil Co. v. FPC*, 292 F.2d 350 (7th Cir. 1961); *Sunray Mid-Continent Oil Co. v. FPC*, 270 F.2d 404 (10th Cir. 1959). This also had been the Commission's view. *E.g.*, *Amerada Petroleum Corp.*, 29 F.P.C. 218 (1963); *J. Ray McDermott & Co.*, 28 F.P.C. 1300 (1962); 43 F.P.C. Ann. Rep. 128 (1963).

⁵⁹³ 327 F.2d 893 (D.C. Cir. 1964).

⁵⁹⁴ *FPC v. Hunt*, 376 U.S. 515 (1964); *Hunt v. FPC*, 334 F.2d 474 (5th Cir. 1964).

grant or deny them.⁵⁹⁵ Because of the summary nature of proceedings for the issuance of temporary certificates, it has been suggested that the Commission has somewhat greater discretion in granting, denying, and conditioning temporary certificates than permanent certificates.⁵⁹⁶ The courts, however, have made it clear that the Commission does not have *absolute* discretion in conditioning temporary certificates.⁵⁹⁷ The conditions attached must be "in accord with the provisions of the act and must meet the test of constitutional due process."⁵⁹⁸ The Commission may attach only reasonable terms and conditions to temporary certificates; it may not act arbitrarily, whimsically, or in a manner that amounts to a clear abuse of its discretion.⁵⁹⁹ The Commission's authority to require reduction of initial rates to the applicable Policy Statement level as a condition to temporary certification has been upheld,⁶⁰⁰ as has its authority to impose a moratorium on rate increases during the term of the temporary certificate.⁶⁰¹ The Commission, however, has been judicially rebuffed in efforts to require "floorless" refunds⁶⁰² or the elimination of Btu price adjustment clauses⁶⁰³ as conditions to temporary certification. Although the propriety of conditions which would require producers to waive their right to judicial review of conditions attached to temporary certificates have not been subjected to direct review by the courts, they have been the topic of critical judicial remarks in one case.⁶⁰⁴

⁵⁹⁵ *Hunt v. FPC*, 306 F.2d 334 (5th Cir. 1962), *rev'd on other grounds*, 376 U.S. 515 (1964); *American Liberty Oil Co. v. FPC*, 301 F.2d 15 (5th Cir. 1962); *Sohio Petroleum Co. v. FPC*, 298 F.2d 465 (10th Cir. 1961); *J. M. Huber Corp. v. FPC*, 294 F.2d 568 (3d Cir. 1961); *Pure Oil Co. v. FPC*, 292 F.2d 350 (7th Cir. 1961); *Sunray Mid-Continent Oil Co. v. FPC*, 270 F.2d 404 (10th Cir. 1959).

⁵⁹⁶ *Hunt v. FPC*, *supra* note 595, at 341.

⁵⁹⁷ *Hunt v. FPC*, 306 F.2d 334 (5th Cir. 1962), *rev'd on other grounds*, 376 U.S. 515 (1964); *American Liberty Oil Co. v. FPC*, 301 F.2d 15 (5th Cir. 1962); *Sohio Petroleum Co. v. FPC*, 298 F.2d 465 (10th Cir. 1961); *J. M. Huber Corp. v. FPC*, 294 F.2d 568 (3d Cir. 1961); *Pure Oil Co. v. FPC*, 292 F.2d 350 (7th Cir. 1961); *Sunray Mid-Continent Oil Co. v. FPC*, 270 F.2d 404 (10th Cir. 1959).

⁵⁹⁸ *Sunray Mid-Continent Oil Co. v. FPC*, *supra* note 597, at 409; *accord*, *Pure Oil Co. v. FPC*, *supra* note 597.

⁵⁹⁹ *American Liberty Oil Co. v. FPC*, 301 F.2d 15, 18 (5th Cir. 1962).

⁶⁰⁰ *Hunt v. FPC*, 306 F.2d 334 (5th Cir. 1962), *rev'd on other grounds*, 376 U.S. 515 (1964); *American Liberty Oil Co. v. FPC*, *supra* note 599.

⁶⁰¹ *FPC v. Hunt*, 376 U.S. 515 (1964).

⁶⁰² *Sunray Mid-Continent Oil Co. v. FPC*, 270 F.2d 404 (10th Cir. 1959). *But cf.* *Public Serv. Comm'n v. FPC*, 329 F.2d 242 (D.C. Cir. 1964); *J. M. Huber Corp. v. FPC*, 294 F.2d 568 (3d Cir. 1961); *Pure Oil Co. v. FPC*, 292 F.2d 350 (7th Cir. 1961). See also *Sohio Petroleum Co. v. FPC*, 298 F.2d 465 (10th Cir. 1959).

⁶⁰³ *Sohio Petroleum Co. v. FPC*, *supra* note 602; *Pure Oil Co. v. FPC*, *supra* note 602. *But cf.* *J. M. Huber Corp. v. FPC*, *supra* note 602.

⁶⁰⁴ *Hunt v. FPC*, 306 F.2d 334, 344 (5th Cir. 1962), *rev'd on other grounds*, 376 U.S. 515 (1964). However, the decision of the Supreme Court held that the Commission has very broad authority in attaching rate conditions to temporary certificates and, hence, diminishes the practical value of the right to judicial review of such conditions.

The decisions dealing with the Commission's conditioning power in issuing temporary certificates are not consistent, in either rationale or result. In *Sunray*,⁶⁰⁵ the first case testing the Commission's authority to condition temporary certificates, the Tenth Circuit invalidated a "floorless" refund condition, *i.e.*, a condition requiring the applicant to refund the difference between revenues received at the initial contract price and those that would have been received at the price ultimately found by the Commission to be required by public convenience and necessity.⁶⁰⁶ The court reasoned that because of the uncertainty of the condition, the applicant was effectively deprived of his statutory choice of accepting or rejecting the certificate and, more importantly, of dedicating or not dedicating his gas to public service. The court observed that an applicant's statutory choice cannot be exercised if the Commission tells him: "Sell your gas; collect your proposed initial price; we will later tell you if you can keep your collections; if we decide you cannot, you must assure refund by bond."⁶⁰⁷ The *Sunray* case⁶⁰⁸ is also noteworthy for its holding that a condition to a temporary certificate barring the discontinuance of service initiated thereunder without Commission approval was not ripe for review because further administrative action was required to adversely affect the applicant.

In *Pure Oil Co. v. FPC*,⁶⁰⁹ the Seventh Circuit, in reversing the Commission's attachment of conditions to temporary certificates requiring elimination of upward Btu price adjustment provisions, appeared to be inviting precisely the kind of condition which *Sunray* held invalid: "Temporary certification of the sale of gas at the initial contract price *upon condition that petitioner refund any amount received in excess of that ultimately found proper in the public interest* would have protected all interests pending determination after hearing."⁶¹⁰

The court's disapproval of the condition imposed was based on its finding that "the record before the Commission does not furnish a sufficient basis to warrant imposition of a condition reducing the initial price of natural gas proposed by petitioner."⁶¹¹ Noting that

⁶⁰⁵ *Sunray Mid-Continent Oil Co. v. FPC*, 270 F.2d 404 (10th Cir. 1959).

⁶⁰⁶ Because such a condition immediately aggrieves the recipient of a temporary certificate to which it is attached, judicial review of a "floorless" refund condition may be obtained only by filing an appeal immediately; an appeal from such a condition at the time of appeal from the order issuing a permanent certificate is not "timely." *Texaco, Inc. v. FPC*, 290 F.2d 149 (5th Cir. 1961).

⁶⁰⁷ *Sunray Mid-Continent Oil Co. v. FPC*, 270 F.2d 404, 409 (10th Cir. 1959).

⁶⁰⁸ *Sunray Mid-Continent Oil Co. v. FPC*, *supra* note 607.

⁶⁰⁹ 292 F.2d 350 (7th Cir. 1961).

⁶¹⁰ *Id.* at 353-54. (Emphasis added.)

⁶¹¹ *Id.* at 353.

the exercise of the Commission's authority to attach conditions to permanent certificates "must be supported by soundly-based findings in the record before the Commission,"⁶¹² the court ruled that limitations on the Commission's authority to impose conditions were not affected by the nature of the proceedings underlying the order. The promulgation of the Policy Statement⁶¹³ was held *not* to be a sufficient basis in itself for reducing the proposed initial price. The court observed that the proposed price was not patently against the public interest and that enforcement of the condition imposed by the Commission would result in irremediable financial prejudice to the producer. The court concluded that the application of the Commission's Policy Statement prior to the completion of proceedings providing a proper legal foundation for a reduction of prices must be accomplished in a manner which protects the producer against prejudice. It was to this end that the court suggested the attachment of a refund condition, as set out above.

In striking contrast to the rationale of the *Pure* case was the decision of the Third Circuit in *J. M. Huber Corp. v. FPC*.⁶¹⁴ Although it quoted with apparent approval the portion of the *Pure* opinion just discussed, and acceded to a Commission request that the matter be remanded for further proceedings "in the light of" the *Pure* opinion, the court in *Huber* took an approach to the Commission's authority to condition temporary certificates that was diametrically opposed to that adopted in *Pure*. The court rejected the producer's contention, based on his reading of *Sunray*,⁶¹⁵ that the Commission's authority to attach conditions to temporary certificates was circumscribed by *all* the standards prescribed in the act.⁶¹⁶ The court observed that the issuance of a temporary certificate is "a summary matter"—"an emergency provision"—and that, unlike other sections of the act, no specific standard was prescribed for the Commission to follow in "fixing rates" upon temporary certification.⁶¹⁷ Viewed in this legal milieu, the court felt that the announcement of the Commission's Policy Statement between the time the producer applied for a temporary certificate and the time it was issued constituted a sufficient legal basis for imposing the rate condition complained of: "*Prima facie* it provides an adequate foundation for the price condition imposed."⁶¹⁸

⁶¹² *Id.* at 352.

⁶¹³ Statement of General Policy No. 61-1, 24 F.P.C. 818, 12 O. & G.R. 1227 (1960).

⁶¹⁴ *J. M. Huber Corp. v. FPC*, 294 F.2d 568 (3d Cir. 1961).

⁶¹⁵ *Sunray Mid-Continent Oil Co. v. FPC*, 270 F.2d 404 (10th Cir. 1959).

⁶¹⁶ 294 F.2d at 569.

⁶¹⁷ *Ibid.*

⁶¹⁸ *Id.* at 570.

In *Sobio Petroleum Corp. v. FPC*,⁶¹⁹ the Tenth Circuit again construed the Commission's authority to condition temporary certificates, this time with *Pure* and *Huber* before it. In this case, as in *Pure* and *Huber*, the condition in question required the elimination of an upward Btu price adjustment from the gas sales contract. After noting the divergent views expressed in the *Pure* and *Huber* cases with respect to the efficacy of the Policy Statement as a basis for price-conditioning temporary certificates, the court expressed agreement with the views of the court in *Huber*. It stated that the Commission was authorized to "initiate" a change in the "in-line" price summarily by a Policy Statement "properly premised upon accepted standards."⁶²⁰ However, the court ruled that because such action on the part of the Commission was ultimately subject to review, the Commission "has the duty to so safeguard the rights of interested parties as to minimize the possibility of discrimination in its summary action."⁶²¹ Here this duty was held not to have been discharged by the Commission because no safeguard was provided the producer against the possibility that the initial contract price ultimately would be determined reasonable, leaving no remedy whereby revenues lost by the producer could be recouped. For this reason, the court held the condition to be arbitrary and discriminatory, and remanded the matter to the Commission. In so doing, however, it commented on the refund condition approved in *Pure* and *Huber*. In those cases, the court observed, the producers apparently did not object to the refund condition, while in the case before it the producer had resisted a Commission offer to substitute such a condition for the one in issue on the basis of the Tenth Circuit's *Sunray* opinion⁶²² holding "floorless" refund conditions to be invalid. Supporting the producer's position, the court strongly suggested that a refund condition would not be lawful absent a "floor" *at the area level prescribed in the Policy Statement*.

In two decisions subsequent to *Sobio*, the Fifth Circuit appears to have adopted the rationale of *Huber*⁶²³ that the Policy Statement is a proper premise for initial price reduction on temporary certification. In *American Liberty Oil Co. v. FPC*,⁶²⁴ the court upheld the imposition of a condition requiring price reduction from the 18 cents proposed to the 16-cent Policy Statement price. The court relied on

⁶¹⁹ 298 F.2d 465 (10th Cir. 1961).

⁶²⁰ *Id.* at 467.

⁶²¹ *Ibid.*

⁶²² *Sunray Mid-Continent Oil Co. v. FPC*, 270 F.2d 404 (10th Cir. 1959).

⁶²³ *J. M. Huber Corp. v. FPC*, 294 F.2d 568 (3d Cir. 1961).

⁶²⁴ 301 F.2d 15 (5th Cir. 1962).

its characterization of a temporary certificate as "an emergency relief for the benefit of the producer,"⁶²⁵ and upon the express language of the act permitting such a certificate to be issued without notice or hearing. It concluded that the Commission's authority to grant a temporary certificate upon the request of a producer, "to alleviate what would otherwise injure him," "may be validly exercised much as a discretionary act," although the court did indicate that the Commission was not free to act "arbitrarily" or "whimsically" or to clearly abuse its discretion.⁶²⁶

Unlike the *Pure*, *Huber*, and *Sobio* cases, the *American Liberty* decision did not discuss the issue of financial prejudice to the producer during the effectiveness of the temporary certificate. Implicit in the decision was the view that the producer would suffer substantial financial harm absent temporary certification, and that a producer who, by the beneficent exercise of the Commission's discretion, had been granted a temporary certificate which would "alleviate" his financial harm should not be heard to complain because he was not initially permitted to collect his full contract price, because any financial prejudice the producer may ultimately suffer would be less than his loss would have been had the Commission denied a certificate.

This view of the Commission's authority to impose price conditions was further supported in the decision by the Fifth Circuit in *Hunt v. FPC*.⁶²⁷ The court again upheld a condition requiring reduction of the initial rate to the Policy Statement level. Noting the absence of a "formalized record," the court concluded that no "tools" were available to construct a thesis showing that it was "completely arbitrary" for the Commission to have required an effective rate reduction.⁶²⁸ The court refused to hold that it was error for the Commission to impose a rate-reducing condition instead of allowing collection of the full contract price and imposing a refund condition. In this connection, the court said:

There are a whole host of problems, legal and administrative, wrapped up in this choice. In the Commission's limited facility for study of the probable ultimate merits of a sale when considering an application for temporary authority, the circumstances would . . . have to be quite unusual to warrant a Court differing with this conclusion inevitably calling for the nicest of expert judgments.⁶²⁹

The court, however, ruled that the Commission had overstepped

⁶²⁵ *Id.* at 18.

⁶²⁶ *Ibid.*

⁶²⁷ 306 F.2d 334 (5th Cir. 1962), *rev'd on other grounds*, 376 U.S. 515 (1964).

⁶²⁸ *Id.* at 339-40.

⁶²⁹ *Id.* at 340.

the bounds of its discretion in attaching a condition prohibiting the filing of a rate increase up to the contract level during the effectiveness of the temporary certificate. The court denied that its statement in an earlier case⁶³⁰ that the Commission's power to condition a certificate "is co-extensive with its power to reject or deny a certificate"⁶³¹ was intended as a declaration that the Commission had authority to impose any conditions short of denial, no matter how harsh. Implicit in its statement, the court said, was a concept of reasonable Commission action. The Commission's effective obliteration of a specific section of the act permitting the filing of rate increases constituted a step beyond the line of reasonableness. To permit such a prohibition of rate increases would be "a complete abandonment of the approach deliberately selected by Congress and which, all must agree, was a radical break with traditional utility-type regulation."⁶³²

Although it conceded that the filing of rate increases to contractually authorized levels would make the maintenance of the "in-line" price something less than completely effective, the court regarded this as an unavoidable consequence of a unique regulatory scheme. It noted the probability of a substantial time lapse before the producer's lawful rate was determined and observed that, under the condition in question, time was irreplaceable to the producer. Fear was expressed that if the Commission could nullify one section of the act, "then there is no end to the legislative tampering which the Commission may undertake."⁶³³ As an example of such a potential Commission abuse, the court mentioned conditions denying judicial review of Commission orders. By footnote, the court took cognizance of the fact that in recent orders the Commission actually had imposed conditions upon temporary certificates which would preclude the applicant from seeking judicial review of the order issuing the certificate.⁶³⁴

The Fifth Circuit's ruling on this point recently has been reversed by the Supreme Court.⁶³⁵ Because temporary certificates may be granted ex parte, the Supreme Court held, "the Commission must have the authority to condition a temporary certificate so as to avoid irreparable injury to affected parties"⁶³⁶ during the pendency of the

⁶³⁰ *Texaco, Inc. v. FPC*, 290 F.2d 149 (5th Cir. 1961).

⁶³¹ *Id.* at 156.

⁶³² *Hunt v. FPC*, 306 F.2d 334, 342 (5th Cir. 1962), *rev'd*, 376 U.S. 515 (1964).

⁶³³ *Id.* at 344.

⁶³⁴ *Id.* at 344 n. 19.

⁶³⁵ *FPC v. Hunt*, 376 U.S. 515 (1964).

⁶³⁶ *Id.* at 523.

application for a permanent certificate. The Court said it did not believe that Congress intended to permit rate conditions imposed upon temporary certificates for the purpose of preventing injury to be "nullified" by the filing of rate increases during the term of such certificates. The provisions of section 4 were declared to be inapplicable to a sale until a permanent or unconditioned temporary certificate covering the sale was issued by the Commission. The Commission's section 4(e) suspension power was regarded as affording insufficient protection to the public against excessive prices which might be collected pending the issuance of a permanent certificate. Accordingly, the Court concluded: "The existence of broad discretionary power in the Commission to condition temporary certificates appears to us to be vital to its ability to hold the line in pricing."⁶³⁷

The Court observed that, whereas delays attendant to section 5(a) rate proceedings operated against the consumer, delays in section 7 certificate proceedings would, under the Court's holding, operate against producers. It stated that "administrative devices" were being employed by the Commission to reduce delays in certificate cases. Nevertheless, unfavorable comment was directed against "the accumulation of a large backlog of cases with its accompanying irreparable injury to the parties."⁶³⁸ Such a situation, the Court warned, might adversely affect consumers "through the reluctance of producers to enter interstate markets because of the long delay incident to permanent certification."⁶³⁹ The Court suggested that a Commission study of National Labor Relations Board exemption practices might be helpful in formulating a method to clear up the Commission's docket congestion and to maintain a clear current docket.

In evaluating the Commission's authority to condition temporary certificates, consideration should be given to a recent decision of the District of Columbia Circuit⁶⁴⁰ involving an appeal from the Commission's *Skelly* decision.⁶⁴¹ The court ruled that the absence of refund conditions in temporary certificates accepted by producers and under which deliveries were initiated did *not* preclude the Commission from

⁶³⁷ *Id.* at 526.

⁶³⁸ *Id.* at 527.

⁶³⁹ *Ibid.*

⁶⁴⁰ *Public Serv. Comm'n v. FPC*, 329 F.2d 242 (D.C. Cir. 1964), *cert. denied*, 377 U.S. 963 (1964).

⁶⁴¹ *Skelly Oil Co.*, 28 F.P.C. 401, 16 O. & G.R. 865 (1962), *modified*, 28 F.P.C. 1065 (1962), *rev'd on other grounds sub nom.* *Public Serv. Comm'n v. FPC*, 329 F.2d 242 (D.C. Cir. 1964), *cert. denied*, 377 U.S. 963 (1964), discussed in text accompanying notes 298-311 *supra*.

requiring as a condition to permanent certification that refunds be made of amounts collected since first deliveries in excess of the price ultimately determined to be "in line." In this connection, the court said:

The basic purpose of the Natural Gas Act is consumer protection from unreasonable prices, and refund of excessive utility rates is a well recognized remedy. *It would need to be quite clear from the Act that the Commission lacked the power to use such a remedy for the courts to deny it.* We find no such clarity. The power does not depend upon an explicit refund provision in a temporary certificate. Should the occasion be appropriate for its exercise *the power resides in the Commission* when it grants a permanent certificate.⁶⁴² (Emphasis added.)

Further, the Commission's authority to require refunds retroactive to first deliveries as a condition to permanent certification was found to be supported by certain "boilerplate" language in the temporary certificates to the effect that acceptance of the producers' rate schedules did not constitute approval of any rate and that such acceptance and the issuance of temporary authority was "without prejudice to such final disposition of the certificate application as the record may require."⁶⁴³ The court agreed that the exercise of the power to impose such refund conditions was not mandatory, but was governed by "equitable considerations." However, it disagreed with the Commission's conclusion that the absence of refund conditions in the temporary certificates was the decisive equitable consideration. Accordingly, the case was remanded to the Commission for "a broader and more penetrating analysis and consideration of the factors pro and con a refund."⁶⁴⁴

The court's ruling in this case on the refund issue is squarely in conflict with the decision of the Tenth Circuit in *Sunray*⁶⁴⁵ invalidating a "floorless" refund condition, for its effect is to build a "floorless" refund condition into every temporary certificate which the Commission issues. This conflict was tacitly recognized by the court in a footnote, and disagreement with *Sunray* was expressed "to the extent that our decision may be inconsistent" therewith.⁶⁴⁶ The court expressed the view, however, that "as a practical matter" the producers had been "relatively assured" of a refund floor of 14.6 cents, the price initially urged by the interveners as the "in-line" price.

⁶⁴² Public Serv. Comm'n v. FPC, *supra* note 641, at 249.

⁶⁴³ *Ibid.*

⁶⁴⁴ *Id.* at 250.

⁶⁴⁵ *Sunray Mid-Continent Oil Co. v. FPC*, 270 F.2d 404 (10th Cir. 1959).

⁶⁴⁶ Public Serv. Comm'n v. FPC, 329 F.2d 242, 250 n. 8 (D.C. Cir. 1964).

The Commission's current policy with respect to initial rates on temporary certification seems to be patterned generally along the lines suggested by the Tenth Circuit in the Sohio case;⁶⁴⁷ i.e., contract prices are allowed to be collected subject to an obligation to refund any amounts collected in excess of those which would have been collected at the rate ultimately determined by the Commission to be required by public convenience and necessity, limited by a floor equal to the area price prescribed by the Policy Statement.⁶⁴⁸ In addition, the Commission prohibits the filing of rate increases during the effectiveness of the temporary certificate.

The Commission's policy of permitting full contract prices to be collected under temporary certificates seems sound. Contrary to the view expressed by some of the courts, there appears to be no basis in law for reducing a contractually authorized price until a record has been made which supports a determination that the price is not required by public convenience and necessity. The Policy Statement is not, could not, and was not intended to take the place of the record in individual certificate cases. This point is made quite clear by the language of the Policy Statement itself.

To deprive gas sellers of contractually authorized revenues—revenues which cannot be recouped—solely on the basis of the Policy Statement would give the Policy Statement an unwarranted substantive effect. The Commission has recognized that the Policy Statement in itself cannot be determinative of whether a particular price meets section 7 standards. As has been suggested,⁶⁴⁹ the only function which Policy Statement prices can serve is procedural, i.e., as price levels which are presumptively valid, subject to being shown by evidence to be too high or too low in a particular case. Allowing producers to collect the full contract price protects them against unwarranted financial harm in the event they are able to support the lawfulness of prices above the Policy Statement level; imposing refund conditions protects purchasers against the possibility that producers will fail wholly or partly to sustain the lawfulness of such prices.

It seems specious to argue that the granting of temporary certificates by the Commission is a matter of administrative largesse and that, for this reason, producers have no basis to complain of being deprived by the Commission of contractually authorized revenues during the temporary term. This argument assumes that a producer can have no *right* to a temporary certificate or, put another way,

⁶⁴⁷ *Sohio Petroleum Co. v. FPC*, 298 F.2d 465 (10th Cir. 1959).

⁶⁴⁸ Statement of General Policy No. 61-1, 24 F.P.C. 818, 12 O. & G.R. 1227 (1960).

⁶⁴⁹ See discussion in text accompanying and following notes 456-459 *supra*.

that the Commission's discretion in issuing or not issuing temporary certificates is absolute. But regardless of whether the Commission's authority to issue temporary certificates to gas producers stems from section 7(c)⁶⁵⁰ or from section 16⁶⁵¹ of the act, it would seem that in circumstances such as those listed in the Commission's regulations as "emergencies," it would constitute an abuse of discretion on the part of the Commission to refuse to issue a temporary certificate to a producer seeking such a certificate. In order to protect the interests of both gas consumers and gas producers, the Commission would seem duty bound to authorize the temporary initiation of gas sales if necessary to avoid the waste of gas or irreparable financial loss to producers. Both circumstances would tend to increase costs that could be reflected in higher rates and would be inimical to consumer need for adequate gas supplies.⁶⁵²

The test by which Commission action on applications for temporary certificates should be measured is that of reasonableness, just as it is with respect to applications for permanent certificates. It must be conceded that because of the difference between the nature of proceedings for temporary certificates and those for permanent certificates, reasonable Commission action in the two kinds of cases must necessarily differ. This difference in procedural characteristics, however, should result in less, not greater, breadth of Commission discretion. It does not necessarily follow from the fact that no hearings are held upon applications for temporary certificates that the requirement accepted with respect to permanent certificates, *i.e.*, that "soundly based findings in the record" be made prior to reduction of contract prices,⁶⁵³ may be dispensed with. On the contrary, the more reasonable conclusion is that the summary nature of temporary certificate proceedings, by making the requisite findings impossible, precludes the imposition of price-reducing conditions upon temporary certificates.

It is not suggested that the Commission should be held powerless to condition temporary certificates. As has been previously stated, the imposition of conditions on temporary certificates requiring refunds of amounts collected in excess of the current initial price level prescribed by the Policy Statement does not seem inappropriate. The

⁶⁵⁰ 52 Stat. 825 (1938), as amended, 15 U.S.C. § 717f(c) (1958).

⁶⁵¹ 52 Stat. 830 (1938), 15 U.S.C. § 717o (1958).

⁶⁵² In its most recent report to Congress, the Commission recognized that its authority to issue temporary certificates "provides an important protection both to the consumer and the industry." 43 FPC Ann. Rep. 128 (1963). In a recent order upholding the issuance of temporary certificates to producers, the Commission conceded that such certificates, by permitting producers to sell their gas prior to completion of the hearing on permanent certificates, "preclude leasehold drainage, flaring or other loss to the producers' (and consumers') detriment." *J. Ray McDermott & Co.*, 28 F.P.C. 1300, 1303 (1962).

⁶⁵³ *Pure Oil Co. v. FPC*, 292 F.2d 350, 352-53 (7th Cir. 1961).

continued use of refund "floors" is, however, imperative. The rationale of the *Sunray*⁶⁵⁴ case seems preferable to that of the recent D. C. Circuit decision⁶⁵⁵ which effectively inserted a "floorless" refund condition in every unconditioned temporary certificate issued by the Commission. It seems needlessly unfair and impractical to expect producers to commit their gas to interstate commerce for a period of time at least equal to the duration of the temporary certificate⁶⁵⁶ without knowing at least the minimum price they may expect to receive therefor. As indicated in the *Sohio* case,⁶⁵⁷ the only "floors" that have any rational bases are the Policy Statement prices. The use of any other "floors" would be a tacit admission by the Commission that its current Policy Statement prices are no longer valid.

Whether the Commission's conditioning authority is to be measured by what is "equitable" or by the more traditional standard of what is reasonable, the Commission should have no authority to require as a condition to permanent certification refunds of amounts collected under a temporary certificate to which the Commission failed to attach a refund condition. The Commission's inaction in this respect should be held tantamount to an affirmative declaration of no refund obligation. The rights conferred and duties imposed by a temporary certificate should be determined prospectively by the order issuing it, not retrospectively by the order which, in effect, terminates it. By even stronger reasoning, the Commission should have no authority to require as a condition to permanent certification refunds of amounts collected pursuant to a temporary certificate below the "floor" level prescribed in the temporary certificate.

D. Duration Of Obligations Under Temporary Certificates

In addition to what conditions the Commission may attach to temporary certificates, consideration should be given to the legal position of a producer who has been issued a temporary certificate and has initiated deliveries pursuant thereto. What obligations does he assume in exercising the right granted by a temporary certificate to commence deliveries prior to the testing of the lawfulness of the sale in a hearing? More specifically, does a producer by commencing gas deliveries pursuant to a temporary certificate thereby obligate himself to continue the deliveries indefinitely until permitted by the Commission to abandon the sale pursuant to section 7(b) of the

⁶⁵⁴ *Sunray Mid-Continent Oil Co. v. FPC*, 270 F.2d 404 (10th Cir. 1959).

⁶⁵⁵ *Public Serv. Comm'n v. FPC*, 329 F.2d 242 (D.C. Cir. 1964), *cert. denied*, 377 U.S. 963 (1964).

⁶⁵⁶ See discussion of the duration of the obligations of producers who initiate deliveries pursuant to temporary certificates in text accompanying notes 658-685 *infra*.

⁶⁵⁷ *Sohio Petroleum Co. v. FPC*, 298 F.2d 465 (10th Cir. 1959).

act,⁶⁵⁸ or are his obligations as temporary as his rights under the certificate? Does a producer who has delivered gas under temporary certification retain the right to refuse an unacceptable permanent certificate and take his gas off the interstate market?

It is the Commission's position that the introduction of a producer's gas into interstate commerce makes that producer a captive of the interstate market with respect to the gas supply in question, and that such producer can be freed from his bonds only by a Commission order approving abandonment of deliveries.⁶⁵⁹ This position is manifested in conditions attached to all temporary certificates providing that once service is commenced under such authorization it may not be discontinued without permission issued pursuant to the act.⁶⁶⁰ There is some judicial support for the Commission's position,⁶⁶¹ but the question of deliveries initiated pursuant to temporary certificates has not been squarely litigated. The only judicial pronouncement concerning the duty to continue deliveries commenced under temporary authority is the following dictum in the Fifth Circuit's *Hunt*⁶⁶² opinion:

His rights may be temporary, but his duties are not, or at least on the present holding they are not. Like the ancient covenant running with the land, the duty to continue to deliver and sell flows with the gas from the moment of the first delivery down to the exhaustion of the reserve, or until the Commission on appropriate terms permits cessation of service under Section 7(b). . . .⁶⁶³

It is submitted that the duration of the obligation to continue deliveries commenced under a temporary certificate should be coter-

⁶⁵⁸ 52 Stat. 824 (1938), 15 U.S.C. § 717f(b) (1958).

⁶⁵⁹ E.g., *Placid Oil Co.*, 30 F.P.C. 283, 293 (1963), *rev'd on other grounds sub nom. Callery Properties, Inc. v. FPC*, 335 F.2d 1004 (5th Cir. 1964); *Sunray DX Oil Co.*, 29 F.P.C. 1295, 1297 (1963); *Hunt Trust Estate*, 16 F.P.C. 831, 832 (1956); *Dixie Pipeline Co.*, 14 F.P.C. 106, 112 (1955). However, if deliveries are commenced to eliminate imminent danger to life or property, no certificate is required and abandonment authority need not be obtained; indeed such deliveries must be discontinued after a period of 60 days. 18 C.F.R. § 157.29 (1961).

⁶⁶⁰ Judicial review of such a condition has been denied on the ground that the recipient of a certificate so conditioned was not "presently aggrieved." *Sunray Mid-Continent Oil Co. v. FPC*, 270 F.2d 404, 407 (10th Cir. 1959).

⁶⁶¹ *Harper Oil Co. v. FPC*, 284 F.2d 137, 139 (10th Cir. 1960); *J. M. Huber Corp. v. FPC*, 236 F.2d 550 (3d Cir. 1956), *cert. denied*, 352 U.S. 971 (1957); *Atlantic Ref. Co. v. Public Serv. Comm'n*, 360 U.S. 378, 389 (1959) (dictum); *Callery Properties, Inc. v. FPC*, 335 F.2d 1004 (5th Cir. 1964) (dictum); *Hunt v. FPC*, 306 F.2d 334, 342 (5th Cir. 1962) (dictum), *rev'd on other grounds*, 376 U.S. 515 (1964). Only the *Hunt* case involved a situation in which deliveries had commenced under temporary certification. The *Huber* case involved a situation in which deliveries had commenced prior to producer regulation and, hence, without certification.

⁶⁶² *Hunt v. FPC*, *supra* note 661.

⁶⁶³ *Hunt v. FPC*, 306 F.2d 334, 342 (5th Cir. 1962), *rev'd on other grounds*, 376 U.S. 515 (1964).

minus with the duration of the certificate. Upon being tendered a permanent certificate, whether conditioned or unconditioned, a gas producer then should be permitted under the act⁶⁶⁴ to decide whether to "dedicate" his gas on a permanent basis to the interstate market on the terms prescribed in the permanent certificate.

The proposition that the obligation to continue gas deliveries endures only for the term of the certificate under which such deliveries were commenced finds strong support in the Supreme Court's *Sunray Mid-Continent* decision,⁶⁶⁵ which upheld the Commission's authority to issue a certificate, unlimited as to term, upon application by a producer for a certificate limited in term to the duration of the basic gas sales contract. This was one of the line of Supreme Court decisions measuring the Commission's authority upon the basis of how the results of affirming or denying the Commission's authority would square with certain broad purposes of the act. One of the results which the Court stated would flow from denying the Commission authority to issue a certificate of unlimited duration upon application for a certificate of limited duration was that a producer who applied for and received a limited term certificate would be free to terminate gas deliveries upon expiration of his certificate without receiving abandonment authority from the Commission under section 7(b) of the act. In this connection, the Court said:

The proposal of petitioner was for a certificate that would by its own terms expire when the contract with United expired. *Thus at the end of the period, petitioner would become free to cease supplying gas to the interstate market . . . without further leave of the Commission, and without there having been made the findings that Congress deemed necessary.*

If Petitioner's contentions, as to the want of authority in the Commission to grant a permanent certificate where one of *limited duration* has been sought for, were to be sustained, the way would be clear for every independent producer of natural gas to seek certification only for the limited period of its contract with the transmission company, and *thus automatically be free at a future date, untrammelled by Commission regulation, to reassess whether it desired to continue serving the interstate market.*⁶⁶⁶ (Emphasis added.)

At another point in the decision, the Court referred to a limited

⁶⁶⁴ Aside from the restrictions of the act, a gas producer may have contractual obligations which affect his freedom of choice. See Doggett, *Marketing by Producer of Natural Gas Through Means—Conventional and Unconventional*, 1 *Economics of the Gas Industry* 193 (1962); Gregg, *Negotiating and Drafting Gas Purchase Contracts on Behalf of the Seller*, 13 *Ann. Inst. on Oil and Gas Law and Taxation* 87 (1962).

⁶⁶⁵ *Sunray Mid-Continent Oil Co. v. FPC*, 364 U.S. 137 (1960), discussed in text accompanying and following notes 549-575 *supra*.

⁶⁶⁶ *Id.* at 142.

term certificate as "an advance license for the abandonment of the continued supply of gas."⁶⁶⁷

In the companion *Sun* case,⁶⁶⁸ the Court stated that if a limited term certificate had been issued, the producer "would after the term have been free to apply for a new certificate to authorize the sale under the new contract."⁶⁶⁹ Implicit in this reasoning is the principle that the obligation to deliver gas is coterminus with the certificate under which deliveries were initiated. Although the vote in both cases was five to four, not even the dissenters questioned this basic principle.

The Commission itself has given specific recognition to this principle,⁶⁷⁰ inconsistent though it be with the Commission's oft-stated position that once gas is turned on, it must remain on until authority to abandon is obtained from the Commission. A recent Commission order observed that the need for producers to obtain abandonment authority remains "so long as there is an outstanding certificate."⁶⁷¹ In denying rehearing of an order issuing temporary certificates to producers, the Commission rejected a request by interveners that the term of the temporary certificates be limited to the duration of the "emergency" occasioning their issuance.⁶⁷² The Commission stated that such request was tantamount to a request "that we determine, upon the issuance of temporary certificates, the time when it will be in the public interest to permit the producer to abandon service without compliance with section 7(b) of the act."⁶⁷³ The Commission thus equated the duration of the duty to deliver gas with the term of the temporary certificate under which deliveries were commenced. Nevertheless, the Commission has not recognized this principle as applicable upon the expiration of a temporary certificate as a result of Commission action on the application for a permanent certificate.⁶⁷⁴

The principle in question appears to be sound. There can be no rational basis for holding in the case of temporary certification that the duration of a producer's duty to deliver gas is different from that of his right to deliver gas, both right and duty being but different views of the same whole. What is the source of a producer's public duty to deliver gas? Is it the issuance of a certificate, temporary or

⁶⁶⁷ *Id.* at 147.

⁶⁶⁸ *Sun Oil Co. v. FPC*, 364 U.S. 170 (1960).

⁶⁶⁹ *Id.* at 174.

⁶⁷⁰ *Continental Oil Co., No. 426A, FPC*, July 2, 1964; *J. Ray McDermott & Co.*, 28 F.P.C. 1300 (1962).

⁶⁷¹ *Continental Oil Co.*, *supra* note 670.

⁶⁷² *J. Ray McDermott & Co.*, 28 F.P.C. 1300 (1962).

⁶⁷³ *Id.* at 1302-03.

⁶⁷⁴ *Placid Oil Co.*, 30 F.P.C. 283 (1963), *rev'd on other grounds sub nom. Callery Properties, Inc. v. FPC*, 335 F.2d 1004 (5th Cir. 1964).

permanent, authorizing the initiation of deliveries, or is it the producer's act of initiating deliveries? Although it appears to be the view of the Commission and of some courts⁶⁷⁵ that it is the latter act alone which imposes the duty to continue deliveries, it would seem that *both* the issuance of a certificate and the actual commencement of gas deliveries pursuant thereto should be necessary to impose the duty to maintain deliveries, and both should be taken into account in determining the scope of a producer's duty.

"Dedication" of gas to public service, which the Commission and some courts have been wont to find implicit in the mere act of commencing deliveries, has *two* elements, (1) intent and (2) an act implementing such intent.⁶⁷⁶ Heretofore, the emphasis has been on the second element—the act of initiating deliveries. It is not suggested that a producer's subjective intent upon beginning deliveries from a gas reservoir be permitted to be determinative of the scope of his obligation to continue such deliveries, nor is it suggested (and this is the gist of the *Sunray Mid-Continent* decision⁶⁷⁷) that the gas sales contract, as an objective manifestation of producer intent, be given controlling effect. It does seem reasonable, however, that the duration of a producer's duty to deliver gas under temporary certification be measured by the term of the certificate pursuant to which deliveries are commenced. In other words, the certificate pursuant to which deliveries are commenced is an appropriate objective measure of the producer's intent to dedicate and, hence, of the scope of the producer's duty to serve.

The certificate under which gas deliveries are made by a producer has been recognized as limiting the *area* from which deliveries can and must be made by him.⁶⁷⁸ Deliveries may not be made by a producer from areas adjacent to those covered by an existing certificate and from which deliveries are being made, absent a new certificate or an amendment of the existing certificate covering the adjacent acreage. On the other hand, it has never been contended that a producer whose wells on acreage covered by an existing certificate are no longer capable of production must maintain production from wells on other acreage not covered by such certificate. There would seem to be no basis, in giving effect to the terms of a certificate, for distinguishing between limitations in area and limitations in time.

A temporary certificate is by definition a limited term certificate, and under the principle announced in the *Sunray Mid-Continent* de-

⁶⁷⁵ See cases cited *supra* note 661.

⁶⁷⁶ See Black, *Law Dictionary* 500-01 (4th ed. 1951).

⁶⁷⁷ *Sunray Mid-Continent Oil Co. v. FPC*, 364 U.S. 137 (1960).

⁶⁷⁸ See *Superior Oil Co.*, No. 437, FPC, July 23, 1964.

cision the obligation of a gas producer commencing deliveries under a temporary certificate to continue such deliveries should also be of limited term. This conclusion is not altered by the "boilerplate" condition which the Commission customarily attaches to temporary certificates providing that deliveries commenced under such certificates shall not be discontinued absent Commission approval. The Supreme Court has made it clear that conditions attached to temporary certificates remain effective only during the pendency of the related application for a permanent certificate.⁶⁷⁹ Hence, the condition in question should expire when the Commission acts on the related application for permanent authority.

Further, to the extent the temporary certificate purports to impose an obligation to maintain deliveries beyond the time the Commission acts on the application for permanent authority, the condition in question seems invalid. The Commission should not be permitted, through its conditioning power, to create a hybrid combining the most onerous features of the certificates specifically provided for by the act. There can be no justification under the act or under any concept of fair play or equity for saddling a producer receiving benefits that are temporary with burdens that are less than temporary.

If a producer's obligation under a temporary certificate is co-terminus with his rights thereunder, it is pertinent to consider the duration of a temporary certificate. Section 7(c) of the act, which until recently was assumed to be applicable to the issuance of temporary certificates to producers,⁶⁸⁰ clearly indicates that such certificates are to be operative "pending the determination of an application for a [permanent] certificate."⁶⁸¹ More to the point is section 157.28 of the Commission's regulations, which states that under "temporary authorizations" issued pursuant thereto producers "may initiate the sale . . . of natural gas in interstate commerce and continue such sale . . . pending final Commission action under Sections 4 and 7 of the Natural Gas Act, and without prejudice to such rate or other condition as may be attached to the issuance of the [permanent] certificate"⁶⁸² The Commission recently has ruled that a temporary certificate ceases to be effective upon the issuance of a permanent certificate applicable to the same sale.⁶⁸³ On this point, the Commission said:

⁶⁷⁹ *FPC v. Hunt*, 376 U.S. 515 (1964).

⁶⁸⁰ See discussion in text accompanying notes 588-594 *supra*.

⁶⁸¹ 56 Stat. 83 (1942), 15 U.S.C. § 717f(c) (1958).

⁶⁸² 18 C.F.R. § 157.28 (1961).

⁶⁸³ *Placid Oil Co.*, 30 F.P.C. 283 (1963), *rev'd on other grounds sub nom. Callery Properties, Inc. v. FPC*, 335 F.2d 1004 (5th Cir. 1964).

In our opinion, once we granted . . . a permanent certificate . . . , the temporary authorization ceased to have any prospective application and was, in effect, automatically cancelled. Assuredly the two charters did not coexist, providing duplicate authority for the same sale. . . . [A]ny temporary authority can only be effective *pendente lite*.⁶⁸⁴

It is reasonable to conclude that a temporary certificate becomes effective upon the commencement of deliveries pursuant thereto and terminates upon (1) denial by the Commission of the application for a permanent certificate or (2) issuance of a permanent certificate and the acceptance or rejection thereof by the applicant. When the temporary certificate so terminates, the applicant should be free to withdraw his gas from the interstate market without further action by the Commission.⁶⁸⁵

IV. CONCLUSION

Since 1954, the Federal Power Commission has been the target of criticism for failure to promulgate regulatory standards governing producers. A reading of this paper at least should make one appreciate the difficulty of the task which has faced the Commission. That the task is difficult, however, does not obviate the necessity for regulatory standards if direct regulation of producers is to be continued. The development of these standards is an absolute necessity if producer regulation is to achieve any degree of rationality.

The Commission's current utilization of the "in-line" approach to the rate issue in producer certificate cases, in combination with the "suspect" price rule and the exclusion of all financial and economic evidence to freeze or roll back prices, amounts to an abandonment of efforts to develop rational regulatory standards in certificate cases. Instead, the Commission has put all of its regulatory eggs in one basket—the area rate proceedings—and pending the outcome of those proceedings has arbitrarily utilized all weapons at its disposal (and some which are not) to maintain the status quo with respect to prices.

The Commission is in error, however, if it believes that the conclusion of area proceedings and the determination of just and reasonable area rates (assuming their validity) will be a panacea for producer regulatory problems. With respect to certificate cases involving sales made after the conclusion of hearings in the area proceedings, the same issues will confront the Commission that face it to-

⁶⁸⁴ *Id.* at 292.

⁶⁸⁵ See Atkinson, *Federal Regulation of Natural Gas—The Independent Producers' Status* 13 Sw. L.J. 425, 461 (1959).

day. The determination of area rates will not be dispositive of these issues.

If the standards of the act as interpreted by the courts are to be applied to producers in certificate cases, then the task must be met head-on; there is no easy way out. No magic formula which the wit of the Commission can devise will do the job. It would appear that appropriate regulatory standards in certificate cases can be worked out only on an *ad hoc* basis, taking into account all evidence presented in each case. Essentially, this was what the Commission was doing in the year which elapsed after CATCO, and before the pronouncement of the Policy Statement. The process, however, was atrophied following the Policy Statement by the policies of the "new" Commission.

The Policy Statement is a potentially useful procedural tool for the development of standards in certificate cases. It could be utilized as a statement of prices presumed to meet section 7 standards and of the adjustments in such prices presumed to be proper for various factors which might not be comparable from sale to sale. It could be amended on an *ad hoc* basis as the Commission's standards evolved and would thereby provide the best possible guidance to producers concerning regulatory standards as they existed at any given time. Under this procedure, as the number of cases decided by the Commission increased, the regulatory standards reflected in the Policy Statement would tend to become more precise, more stable, and more reliable. The basic standard in certificate cases with respect to proposed initial prices should be the current market price.

The foregoing comments have assumed the continuation of direct producer regulation. It would appear, however, that the Commission's struggles in the morass of producer regulation have been as needless as they have been futile. Consumers could be given all the protection to which they are entitled against excessive gas prices at the point of production and the Commission's regulatory burden could be virtually eliminated if gas producers were exempted from direct regulation and were, instead, indirectly regulated through close examination by the Commission of pipeline purchased gas costs.

Assuming *arguendo* that all the staggering problems of producer regulation could finally be resolved, there would still be no justification for continuing regulation for regulation's sake. Producer regulation has been a costly experiment. Ten years after its inception, standards have not been developed and there is no promise that they will be developed in the foreseeable future. The experiment has failed. It should be abandoned.

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